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Editorial Comment

*Watchman,
What of
Tomorrow?*

At its meeting last month the Executive Committee of The Dominion Association of Chartered Accountants considered the importance and advisability of a study being undertaken by our Association of post-war problems.

Most members of the profession in Canada would probably respond to such a proposal by suggesting that the aim of us all for the present should be to trounce Hitler and his partners; then we can discuss reconstruction. True, our first concern is to get on with the war and to bring it to a successful conclusion; nothing should interfere with an all-out effort to that end. Recollection of the aftermath of the last world war, however, forces us to realize that tremendous problems will have to be attacked immediately peace is restored to a worn-out and sorry-looking world, and that it is not too soon to make preparations now for the post-war situation.

The *debâcle* of a quarter century ago which followed the armistice in 1918 will call to the mind of readers that dramatic parable presented nineteen hundred years ago, of the evil spirit cast out of a man—in our case the body politic. The spirit walked through dry places seeking rest, and

finding none decided that he would return to the house from whence he was cast out. When he came he found it "empty, swept and garnished." Then went he and took other spirits more wicked than himself and they entered in and dwelt there. And the last state of that man was worse than the first.

No one will want a repetition of what followed the great war of 1914-18. Mr. Churchill and Mr. Roosevelt in their Atlantic meeting some months ago have laid the foundations for peace and justice for helpless nations at the close of the present struggle. With the full co-operation of all the nations brotherhood must be the occupant of the world's house "swept and garnished" to receive it.

*Foresight
of Our
Forefathers*

The proximity of war to Great Britain's shores and the daily menace of death-dealing bombs to her population and her industries should be reason enough, one would think, for everybody in the Old Land to be wholly occupied in the programme of building guns and ships and other instruments of defence. Such activities surely appear sufficient to meet the exigencies of the moment; why not let the future then take care of itself? But that is not the British way. Any such suggestion is contrary to the traditions of our forefathers and tends to belittle the deeds of those men of vision who became the founders of empire and of the Commonwealth of Nations of which we proudly form a part. Moreover such suggestion disparages the aims of the gallant defenders there who will die if need be to preserve that heritage. Our leaders charted "better than they knew." Their hand was at the helm of state; their eyes were also scanning distant horizons. Their watchwords, we think, could have appropriately been expressed for future generations: Today's duties are in hand; what of tomorrow and tomorrow?

*Profession in
Great Britain
Alert*

In the midst of the world's chaotic conditions the people of Great Britain retain the broad outlook. Committees of government are already studying problems of reconstruction. In this issue we publish the fourth in the series of articles on the subject, "The Future of Auditing." The series was prepared by a committee of profes-

sional accountants in Great Britain who a year ago began a study of post-war problems in so far as the profession of the practising accountant could contribute to their solution. We have chosen the fourth for publication in *THE CANADIAN CHARTERED ACCOUNTANT* since it is devoted primarily to a discussion of the requirements of the "financial police force" that they visualize as being necessary in future days to prevent anti-social behaviour and the misuse of power.

The first article is historical. The reader is reminded of some of the effects of the industrial revolution of the nineteenth century—the need for additional capital in expanding industry, the rise of the joint stock company and the limited liability of shareholders which encouraged small investors (who had been reluctant to invest in companies run by persons whom they did not know and trust) to part with their savings. It only remained to safeguard the interest of shareholders, and the authors observe that during the past sixty years or more the professional accountant has fully lived up to the conception of his responsibilities, namely, of assuring shareholders that the financial position of the company in which they have invested capital is as stated by the directors in the balance sheet at a given date. Now there arises the question of the adequacy of the present financial audit to satisfy the genuine requirements of shareholders. Three major factors are discussed which would give reason why such verification of the financial condition at a given date is entirely inadequate—(1) the end of the period of expansion in industry, (2) the separation of ownership from control, and (3) the passing of the era of free competition, with its automatic economic incentives to efficiency in management, and the development in each market of a relatively small number of large concerns who exert a considerable measure of control over the price of their products. Inasmuch as directors in many cases have no great stake in profits or dividends, it is reasonable and legitimate for shareholders to ask for assurance that the business on which their livelihood may wholly depend is being managed on a sound basis.

*Good Management
in Industry*

The second article deals with the growing interest of society in good management. It sets out the difficulties encountered under the modern in-

dustrial system by the individual in perceiving the true interests of the society in which he lives. One advantage of the feudal system of the middle ages in England was that it was a reasonably intimate and humane form of organization, involving personal relationships between employers and employed and distinct obligations and rights on both sides. A change came with the industrial revolution. The application of steam and other kinds of power greatly increased man's ability to convert the resources of nature to his own benefit. Little by little the old human relationships between employer and employee were swept away and, quite as significant, the former contact of producer with the consumer of his products was completely severed. In support of their contention that society—or, as we say, "the state"—cannot divest itself of responsibility for present policies in industry, the authors refer to some conditions or circumstances which permit individuals to put their own interests above the true interests of society:—the present code of company law which enables persons to escape the consequences of their actions and policies; the loss to the state of income tax on profits because of avoidable waste and inefficiency in industry; the expense to the public in bolstering up inefficient industries; and the removal of stimulus to efficiency through the exercise of producer price jurisdiction.

Preventing Anti-Social Behaviour

The prevention of anti-social behaviour in industry is the subject of the third article in this series. What constitutes efficiency in industry? The committee recognizes the fact that the question cannot be answered simply in material gain or monetary advantage; ultimate human satisfactions must be recognized as a factor. To determine the present position of business concerns and to make a comparison of the results of their operations with known standards require surveys by specialists. In laying down standards of conduct for business, which might be applied to the data collected under the business survey and which will act as a preventive against abuses growing to excess, it is suggested that society will require the services of a body of professional men of "unimpeachable character," skilled in industrial and business problems, to audit individual industrial units and ascertain whether

or not the standards or controls are being maintained. Could anyone be better placed, the committee asks, for holding a watching brief in the public interest than members of the accounting profession? They have the entrée to every commercial undertaking of any consequence in the country.

To what extent can our profession tackle the undertaking as described by this committee in Great Britain? That is the subject of the fourth article which we publish this month. Evolution has played an important part in the development of human institutions and it is preferable to proceed by the adaptation of known and tried ways. If, however, the development of the body politic by such orderly process is retarded by inertia or is bogged down by dead matter, the condition of the patient, the committee points out, may demand new-found remedies. Its inquiry is then: "In view of the need of society for safeguards in the industrial machine, what is to be the answer of the profession of the public accountant?"

Is the proposal or undertaking of the committee feasible? We live in a complex society. It is by no means easy to reach an agreement on whether this or that everyday action in industry is anti-social. The Editorial Committee invites the observations of members of our profession on this interesting subject.

Valuation of Inventories This month we publish the results of a thoughtful study on the valuation of inventories made by C. B. Wade, C.A., and J. E. Ferguson, B.Com., of Queen's University, Kingston. Immediately following the article are some observations by Mr. D. McK. McClelland, F.C.A., chairman of the committee on accounting research of our Association.

The valuation of inventories is a matter of much diversity of opinion and lack of consistency as this study has demonstrated. It is a subject to which considerable attention has been given in the United States. Although no statement of the results of its researches has been released by the committee on accounting procedure of the American Institute of Accountants, we note nevertheless that in its first general bulletin issued in September 1939 "a more exact determination of the basis of inventory valuation"

tops the list of matters to receive the attention of the committee.

The Bureau of Internal Revenue of the United States Treasury Department is making continued study of the valuation of inventories and has treated the subject at length in its annual volume of regulations relating to the income tax under the Internal Revenue Code.

The "last-in, first out" method of valuing inventories for Federal income tax purposes is permitted in certain cases under section 19. 22(d) of that Code. The provisions of the income tax regulations in the United States bearing on this method are set out at length on pages 201-204 of the *Internal Revenue Bulletin* for the first six months of 1941 (Cumulative Bulletin 1941-1, 45 cents U.S. currency, Superintendent of Documents, Washington, D.C.) and will be found both interesting and instructive to the reader. It is possible that most of the reference libraries of our Provincial Institutes have a set of the annual volumes of these Regulations.

As Mr. McClelland has indicated in his remarks, members of the profession are invited to send in their observations on this subject.

THE FUTURE OF AUDITING

Editor's Note: In Great Britain post-war problems are already being studied. A year ago a number of professional accountants employed in various industrial undertakings throughout Great Britain decided to form themselves into a group for the study of some of the problems of the post-war world, in so far as they as accountants could contribute to their solution. A series of four articles on the subject "The Future of Auditing" was the result of their work and the series was published during January 1942 in *The Accountant*, the official journal of The Institute of Chartered Accountants in England and Wales. In the words of the Editor of *The Accountant*, the first article endeavoured to show that the financial audit is inadequate, even to satisfy the genuine requirements of shareholders; the second emphasized the growing extent of the direct interest of society in good management; the third reviewed the method of preventing anti-social behaviour in industry and the tools available to society for making this prevention effective; and the fourth and final article in the series discussed the part society may require the accounting profession to play, and asked what is to be the attitude of the profession.

The Editorial Committee welcomes the opportunity of publishing this month the fourth article of that series.—A. H. C.

The Question for the Accounting Profession

The auditor was once described, in the judgment in the famous *Kingston Cotton Mills* case, as a watchdog rather than a bloodhound, a policeman rather than a detective. Is it too fanciful to think that, rather than confine his guardianship to the interests of one group of people only, the auditor may soon develop into a watchdog on behalf of society in general? When the interests of society demanded it, we built up a police force for the prevention of crime. With the development of motor cars, it has become necessary to have mobile policemen to prevent an irresponsible minority from becoming a danger and a menace to other users of the road. With the development of industry, what is more natural than that society should find it necessary to build up a special kind of financial police force to prevent anti-social behaviour and misuse of the power which the financial control of industry gives to some socially irresponsible individuals?

To what extent can the accounting profession tackle the job, and how far can it provide the personnel for such a force? That is the principal question which is being put to the profession in this series of articles. In searching for the answer, the shortest way seems to be for us to try to point out certain weak points in the armour of the average professional auditor of today—not in any deroga-

tory spirit, but because it is only by so doing that a proper attempt can be made to assess his suitability for the task. His good qualities and moral integrity are not in question. In expressing our views, however, we have not attempted to mince matters, believing candour to be of value to the discussion.

In the first place, the auditor suffers from much the same handicap as the accountant in industry, in that he is almost bound to be influenced by the wishes of those who pay him his fees and are, in effect, not even shareholders, but directors. He cannot be expected, therefore, to pronounce impartial verdicts from the point of view of the interests of society. If that is desired of him—or anyone else, for that matter—it would seem that he must be paid by the State. This need not mean, however, that the profession should be managed by the State or even become a part of the Civil Service. All the change it necessarily involves is that, on completion of their work, auditors should have their fees paid by the State, either out of central taxation or out of a special fund built up by a uniform levy over the whole field of industry.

Some Deficiencies in Training

That weakness does not apply merely to accountants. It would apply to anybody who was given the task of watching the public interest and was paid as well as chosen by the person he had to watch. There are other weaknesses, however, which are largely peculiar to the accounting profession and would not necessarily apply to others. For example, the auditor's training is almost entirely that of a historian. This tends to make it difficult, if not impossible, for him properly to understand those aspects of business which attempt to assess future possibilities. It tends to over-emphasize his latent conservatism. It tends to make him over-cautious. Business is generally a gamble, though the decision to take a risk is often backed up by sound judgment. It cannot be run for long on "safety-first" lines.

Training is connected with experience, but the auditor's experience also has been narrow, being built up generally on the basis of figures in which the £ is the be-all and end-all. Business is much more than a matter of pounds, shillings and pence; it is partly an engineering problem, but even more a problem of the association of human beings

and their organization in groups for the purpose of making jointly their several contributions to the whole business of providing for the needs of the community. There are many occasions when a company's accounts may be open to criticism from the purely financial angle, but when the larger human issues involved should far outweigh any immediate monetary considerations.

The deficiency in training, however, can be remedied, though subsequent practice may nullify its effect to a great extent. The basis of experience can be broadened; for example, it may come to be regarded as a necessary qualification of the auditor of the future that he shall have had some practical experience inside industry itself. But practical experience as an accountant in industry will only help him to see the other side of the picture of financial auditing. It will not necessarily help the prospective auditor to get an insight into the problems of administration and management, for accountants in industry are themselves horribly subject to the £ s. d. complex.

A matter of fundamental importance to the consideration of this problem is the mental attitude of the average auditor. Among the many types of mind in the world, there are those of the man of action and the man of study. The accountant who stays in the profession—like the Don and the Lawyer—prefers to deal with words and abstractions. He is very often quite unfitted by his character and temperament to go out into the world of action and get practical experience of management and of handling men and affairs. There are, of course, exceptions. But, in the main, the bulk of those who have the urge for action do leave the profession anyway, and their professional training is only a stage in their future career.

That the auditor has shown himself incapable so far of appreciating the wider implications of business problems is exemplified by his attitude to reconstructions in the last twenty years. Throughout that period, he has acted as though he thought that all that was necessary for the remedy of industrial ills was a skilful manipulation of figures, either within a company, or between a group of companies. Rationalization has appeared to him to be almost entirely a financial problem; questions of market potentialities, managerial capacity and organization structure—not to men-

tion the problems of social dislocation caused by the rise and fall of the industrial barometer—have obtruded themselves hardly at all upon his financial consciousness.

In the previous article, a guess was hazarded that the management consultant might develop into something in the nature of an industrial surgeon. Would it follow, then, that the auditor of the future might come to occupy in the business world a position similar to that occupied by the general practitioner in the medical world, that is to say, having the function of keeping the individual units of industrial activity in reasonable health? But that postulates for the auditor the power of diagnosis. It is very doubtful, therefore, whether he could even try to act in that capacity, because he has not the instinct, the training or the experience to do more than record bad results and is quite incapable in most cases of saying how and why the bad results have occurred.

Arbiters of Management

It follows from what has been said that there can be no question of the whole accounting profession being converted into the new body of professional business men for whom we are searching. That there would be any such ready-made solution to hand was hardly to be expected. For what we are looking for is a body of men who would act, in effect, as the arbiters of management. The qualities required in combination for this purpose will not be found in many people, and it is very unlikely, to say the least, that there will ever be enough people of the requisite calibre in the accountancy profession—or in any other—to see the task through to its logical conclusion.

And yet something should be done. For on the one hand society is in need of some regulatory machinery to prevent those in control of individual units of industrial activity from exploiting their position for their own benefit and contrary to the interests of the welfare of the whole community; while, on the other hand, the accounting profession has access to the records of all industrial units for purposes of taxation or audit or both, and—though this is likely to be vehemently denied by some members of the profession—the tide of its social utility is at a very low ebb. It would appear, therefore, that it would not only help to meet the requirements of society, but also serve the true interests

of the accounting profession, if use could be made of the facilities it offers.

First of all, however, a word of warning. It will be no proper solution of the problem for firms of auditors merely to engage men who style themselves management consultants and to set up management consultancy departments, but otherwise to continue the present practice and methods of auditing more or less unchanged. For what would happen then would be that the management consultants would take on an accounting bias, whereas what is needed, if accountants are to be of use to society for the work under consideration, is that accountancy should take on a management bias. On the whole, it would seem that there is much more to be lost than gained at present by the profession of management consultancy joining forces with the auditing profession, for their functions are quite separate and distinct.

The auditing profession may, in fact, be able to make a definite contribution in its own particular sphere towards meeting the requirements of modern society. The contribution may not go as far nor be as complete as some people would wish, but it will at least be a step forward, another stage in the process of evolution. The trouble with the profession at the present time is that its leaders seem bent on doing nothing more than maintaining the *status quo ante*. But nothing stands still in the world around it. Just as in nature the scene is constantly changing, some things growing, others dying, so human institutions cannot halt their growth indefinitely. Either they develop in conformity with their surroundings or they become overgrown with weeds and perish.

What Supervision of Industry Means

Now, the supervision of industry which we have envisaged falls into three broad divisions, relating to finance, ethics and management effectiveness. Of these, the task of financial supervision pure and simple is relatively the least important, and yet it is this which occupies nearly all the time of the auditing profession at present. Consequently, if the profession is to play its part in the broader and more general supervision of industry, it must devote much less time to the purely financial aspect. Such a step will necessitate a drastic revision of the technique of fin-

ancial auditing, so as to ensure that attention is paid to those facets of the problem which are of real importance and that work is eliminated which has ceased through changing circumstances to be of value.

It is no part of the purpose of these articles to show in detail how that can be done. That is one aspect of the general question facing the profession today, and requires much thought for its proper solution. Certain observations, however, may be put forward. Much time on an audit is still being spent looking for arithmetical and clerical errors, in spite of the fact that in many cases the risk of arithmetical errors has been almost entirely eliminated by the development of office machinery. Moreover, the time spent on looking for errors betrays a false sense of proportion.

Then again, the watch for fraud is often accompanied by much unthinking routine vouching, when it is possible that a far more effective and, in point of time, more economical check could be made by thoughtful study of the routines through which the documents are passed and of the relationships between the individuals concerned. We realize that the auditor is already supposed to do this in theory, but in our experience what he does in practice is different. The auditor not only does not discharge his duty but also wastes a considerable amount of time and effort by sending in to his clients a bunch of clerks to tick and cast and vouch, without really knowing what they are supposed to be doing.

Before leaving the financial aspect altogether, it may be as well to remind ourselves that, while accuracy is desirable in accounts, absolute accuracy is never in fact obtainable because of the many uncertain and constantly changing factors in industry. Fashions may change over the weekend or scientific developments may suddenly mature, which will render valueless the most careful attempts to figure out the written-down values of property and plant. That is no reason, of course, for not striving to make accounts as accurate as possible. It is a reason, however, for trying to keep things in proper perspective and for not paying too much attention to sprats when there are far larger fish in the sea.

Ethical Standards

The accountant should be able to tackle the ethical supervision of industry just as well as any other layman—

provided, of course, that the ethical standards are first established by the appropriate authority. The standards themselves would be negative rather than positive; that is to say, they would define socially undesirable practices. If that were done, the professional accountant would be able to take in his stride the task of seeing that the individual units of industrial activity did not indulge in anti-social behaviour. But, first, he must get rid of all unethical practice in his own profession.

It will be recalled that it was suggested in the last article that a select body of persons, thoroughly versed in the ramifications of business, should analyze our industrial abuses. For example, the Eighth Commandment might be translated into terms of modern opportunities for industrial and commercial stealing. That done, and even in the absence of legislation to prevent theft of that nature, a united auditing profession could still serve a useful purpose by giving full publicity to instances of that type of abuse.

As to the method of enforcing ethical standards, an interesting experiment is taking place at the present time. Retailers of certain commodities are not allowed to deal in those goods without licences. Further—and this is the important point—they are liable to have their licences suspended if they are naughty and transgress the regulations laid down in the interests of the whole community.

The supervision of management effectiveness is a much more difficult affair, since in general the auditor cannot hope to possess even a small fraction of the technical knowledge required to form a sound judgment. It is necessary, therefore, to consider to what extent this task can be removed from the realm of individual judgment by establishing standards of performance, industry by industry. For then the auditor could confine himself mostly to figure work (which is his trade), examining cost accounts and obtaining from that or any other relevant source the information he requires in order to compare the performance of the business under review with the predetermined standards for the industry.

Here again we are not setting out to show in detail how this can be accomplished, but content ourselves with offering certain observations. Further investigation should

be made only on the exception principle. If the comparison was satisfactory, no further action would be taken. If, however, the comparison indicated unsatisfactory performance generally, or in any particular direction, there would be a *prima facie* case for closer scrutiny. At that stage, however, the auditor, *qua* auditor, would have finished his work, and the question of who should undertake that further investigation would depend on the type of unsatisfactory performance suspected. The management consultant is an obvious and likely candidate. Further, society may find it necessary to set up panels of technical experts to whom technical problems could be referred for expert adjudication.

Uniform Methods Necessary for Comparison

If development is to take place along these lines, it will involve the establishment of uniform methods of costing and accounting for each industry, so that the standards of performance can be expressed in figures and ratios against which the results of individual firms can readily be placed on a strictly comparable basis. The difficulties of developing a uniform system for an industry are admitted; but they are not insoluble. The major difficulty hitherto has arisen from the fact that adoption of the scheme is usually voluntary and consequently those who have designed it have had to sacrifice principles in the desire to discover a basis which would secure the widest acceptance. The result of this approach to the problem has been either failure to produce a scheme at all, or else the production of a scheme so colourless that interest soon flagged. Generally speaking, if the attempt to establish a uniform system is to be successful, the basis on which it is built should represent the best current practice, and firms whose systems do not conform to it should be compelled to adapt their procedure within a reasonable period of time.

It will also involve the abandonment of the idea that a company's figures are its own secret. There can be no longer any imaginary duty of an auditor's secrecy to his clients—quite apart from the fact that the auditor-of-the-future's real client will be society in general. Figures of individual firms must be freely available to those determining the standards of performance for the industry, while those standards and certain classes of total or aver-

age figures for the industry should receive the widest publicity.

A further, and most important, point is that if society is to receive the assurance it requires that the goods (and services) it needs are made available to the ultimate consumer of them at the cheapest possible price, having regard to quality and a reasonable recompense to those whose efforts have contributed, directly or indirectly, to making them, it will be essential for all processes from the original conversion of the raw material to the final delivery of the finished article into the hands of the consumer to be viewed as a whole. Only by so doing can the relative costs of manufacture, selling and distribution be ascertained.

This and other considerations already mentioned may make it necessary for the auditing profession to reorganize itself on lines which will coincide with the altered conception of its duties and responsibilities. It seems clear, at any rate, that there is important work to be done and that the present structure and standards of the profession are not adapted to that end.

Perhaps someone who has read these articles will be moved to point out that we have not taken sufficient notice of existing laws and their requirements. We are fully aware, of course, of the effect of legislation at present on the Statute Book and of certain leading pronouncements of learned judges. We deeply deplore, however, the attitude of mind which is prevalent in the profession today, which accepts legal formulae as unalterable facts and refuses to think in terms of the needs of human society. Naturally, we must not disobey the law. But laws impose minimum, not maximum, standards. Nor are they immutable; they can be changed when public opinion demands a change. But too rigid an adherence to the letter of the law, by those whose business is not legal, stifles the thought and keeps in check the growth of enlightened opinion which alone supply the motive power to keep our laws adjusted to the ever-changing circumstances of a continually evolving situation.

Democracy allows people freedom of thought and action, provided they do not by their actions cause harm, loss or disturbance to other people. Experience has taught us that men, if left to their own devices, cannot be trusted so to

conduct themselves as not to harm their fellows. Society, therefore, has always had to erect barriers round the danger spots. Hence the Ten Commandments and also, for example, the Common Law of England.

Of recent years, the ramifications of industrial activity have become so extensive that they touch the lives of each one of us at many points. There has been a corresponding increase in the power of those in control of industry to affect for good or ill the livelihood and happiness of many people apart from themselves. It is, therefore, necessary for society to create machinery to prevent those in any one unit of industrial activity from exploiting their position to the detriment of others and for their own benefit.

Now, in the development of human institutions, it is considered preferable to proceed by evolution, by adaptation of known and tried ways, and by modification of existing regulations and institutions to meet changing conditions. If, however, the development of the body politic by the orderly process of evolution is retarded by inertia or blocked by a sluggish accumulation of dead matter, the condition of the patient may demand a revolutionary remedy.

In view of the need of society for safeguards on the industrial machine, what is to be the answer of the auditing profession?

VALUATION OF INVENTORIES—A STUDY

By C. B. Wade and J. E. Ferguson,¹
Kingston, Ontario

Scope of Enquiry

THE primary purpose of the study was to ascertain what inventory valuations were used in 1939 by a large sample (approximately 200) of Canadian public companies.

The intention was to find the extent to which different valuations were used—no effort was made to ascertain the definitions of the different valuations. Thus information was not sought about the various methods of measuring historic cost or replacement cost or selling price or standard cost, etc.

The data comprised published financial statements and letters of explanation obtained from quite a number of concerns.

Valuation of Inventories of Raw Material

The following table gives the findings of the enquiry into the valuation of raw materials.

TABLE I
Valuation of Inventories of Raw Materials in 1939,
by 202 Public Companies

Valuation	Number of Companies	Percentage of Companies
Lower of cost or market ² ..	123	60.9
Cost	50	24.7
Below cost	26	12.9
Market	3	1.5
	202	100.0

This data seems definitely to establish the preponderant use of the lower of cost or market valuation for raw materials. This preponderance would appear overwhelming if it were discovered that the twenty-six "below cost" valuations were in effect lower of cost or market valuations, less reserves.

¹This article is based on a thesis written in candidacy for the degree of Bachelor of Commerce (Queen's University) by J. E. Ferguson, B. Com. The article was written by C. B. Wade, Chartered Accountant, who also did some further research.

²It was established that in all cases "market" referred to the cost of replacing the materials.

It might be as well to reiterate that the study did not embrace an enquiry as to the meaning of "cost."

Valuation of Inventories of Finished Goods

Table II gives information similar to that of Table I, but for valuations of finished goods.

TABLE II
Valuation of Inventories of Finished Goods in 1939,
by 202 Public Companies

Valuation	Number of Companies	Percentage of Companies
Lower of cost or market	103	51.0
Cost	56	27.7
Below cost	19	9.4
Standard cost	5	2.5
Market ³	19	9.4
	202	100.0

At first sight it would seem that the above table shows that the methods of pricing finished goods were very similar to those applied to raw materials. This deduction however is justifiable only on the assumption that the term "market" means, as it does for raw materials, replacement cost, but the information obtained from correspondence does not validate this assumption.

Meaning of "Market Value"

In response to requests many companies replied with explanations of what they meant by the term "market value." Unfortunately though all clearly explained that for raw materials the term meant "replacement cost," most were either very ambiguous about, or omitted any reference to, the use of the term for finished goods.

However a few replies were clear and explicit. The number of such replies were insufficient to form any certain opinion of majority use, but they were sufficient to prove that no unanimity of opinion exists. The following table shows this in summary form.

³Fifteen of these companies were grain and gold mining concerns.

VALUATION OF INVENTORIES—A STUDY

TABLE III

Definitions of "Market Value" of Inventories of Finished Goods,
as Obtained from Correspondence with 11 Public Companies

Company and nature of business	Description of finished goods valuation on balance sheet	Meaning of "Market" value
(A) Rubber goods manufacturing	Lower of cost or market	Replacement cost
(B) Retail food stores	Lower of cost or market	Replacement cost
(C) Retail soft drink stores	Lower of cost or market	Replacement cost
(D) Oil refining & distributing	Current cost, which is below market	Selling price
(E) Oil refining & distributing	Cost, which was lower than market	Selling price
(F) Metal mining	Lower of cost or market	Selling price
(G) Electrical equipment manufacturing	Lower of cost or market	Selling price
(H) Primary steel producing	At values which do not exceed the lower of cost or market	Selling price
(I) Binder twine manufacturing	At cost, not exceeding market value	Selling price, less selling expenses
(J) Wine goods manufacturing	Not exceeding lower of cost or market	Selling price, less selling expenses
(K) Retail food stores	Lower of cost or market	Selling price, less average mark-up

It will be observed that the term "lower of cost or market" may mean either "the lower of cost or replacement cost," e.g. company (A), or "the lower of cost or selling price," e.g. companies (F) and (H).

Where an inventory is described as being valued at the lower of cost or market, and market means selling price, it is reasonable to think that in fact the inventory is valued at cost. This was explicitly stated to be so by one company from whose explanatory letter we quote: "Our inventories are valued at cost—that is, cost of raw materials plus manufacturing or processing expenses only, and the fact that the term 'Lower of cost or market' is used is simply an explanation to our shareholders that in valuing our inventory at cost we are using a figure which is below the market price. The market price is very easily established in view of the fact that in the . . . industry there exist published selling prices."

And a letter from a company which on its balance sheet described its finished products as being valued at the lower of cost or market said in part: "Our inventories of . . . are, in general, valued at cost; when market is lower than this

cost, market values are used . . . market value is determined by using the unit selling price prevailing in recognized markets on the last day of the fiscal period for spot deliveries of the principal commodity."

On the other hand, when "market" means "replacement cost," the term "lower of cost or market" as applied to finished goods may mean that each class of goods is valued at cost or replacement cost, whichever is the lesser amount. We quote from another letter: "In a company like ours . . . should there be a market price [this refers to replacement cost—C.B.W.] at the end of the year lower than the cost valuation, the amount of inventory write-down on raw materials is fairly easy to determine . . . it is not a difficult matter to determine the poundage of . . . in the goods in process and this inventory can be written down to give effect to the market prices as of the end of the year . . . the same is also true of the finished goods, all . . . are manufactured according to specifications and from these specifications it is fairly easy to arrive at the approximate content of . . . [the raw materials—C.B.W.] in these goods."

It will be noted that for this company the market value of its finished products seems to be the lower of cost or replacement cost of the raw material content plus the cost of processing.

One can conclude that Table II does not present an accurate story; it is quite certain that the number of companies that value their finished goods inventories at cost are significantly understated. In fact it appears to the writer that relatively few manufacturing concerns (as distinct from wholesale and retail) will go to the trouble and expense of ascertaining the replacement cost of their finished goods as at the year end. Though the sample is far too small for any conclusions, it is interesting to see that of the eleven companies of Table III, eight valued their finished goods at cost except when cost was more than selling price or selling price less certain expenses or mark ups. It is also worthy of note that only one example of a *manufacturing* concern using replacement cost is found on the above mentioned table; the other two companies using replacement cost as "market value," were retail concerns.

Before leaving this topic it is interesting to observe that the great majority of letters received stated that pricing at cost or at "market" whichever gave the lesser figure,

VALUATION OF INVENTORIES—A STUDY

was applied to each item, i.e. to each class of goods, not to inventory totals.

Quantitative Importance of Inventories

In order to get some measure of the importance of inventory valuation so far as it relates to income measurement, ratios of inventory values to profits were worked out. These are given on the table below.

TABLE IV
Percentage Ratios of Net Profit to Inventory
as found in
151 Canadian Industrial Concerns (1939)

Industrial Groups	Inventory (000 omitted)	Net Profit (000 omitted)	Percentage ratio
Pulp and paper products	\$52,092.4	\$4,546.0	9.5
Iron and steel	44,506.4	6,772.1	15.2
Electrical products	12,670.6	3,298.3	26.0
Household goods	4,636.3	811.9	17.5
Distillery and beverage	82,428.0	16,725.5	20.3
Grain and flour	24,253.8	2,645.7	10.9
Bakeries	2,074.7	1,613.5	77.8
Construction	4,589.6	210.5	4.6
Building materials	8,678.8	4,738.0	54.6
Textile products	16,037.8	5,438.1	33.9
Merchandise	15,764.5	3,057.0	19.4
Foods	5,841.7	3,616.3	61.9
Packing and canning	19,021.2	1,429.4	7.5
Mining	46,674.0	48,450.0	103.8
Oil	32,179.0	23,901.7	74.3
Miscellaneous	44,403.6	30,926.8	69.6
Average			37.8%
Median			23.2%

These figures bring home rather sharply how a relatively insignificant percentage decrease or increase in value of inventory may result in significant decreases or increases in net profit.

VALUATION OF INVENTORIES

Some observations by D. McK. McClelland, F.C.A., on the study made by C. B. Wade and J. E. Ferguson on the Valuation of Inventories. Mr. McClelland is Chairman of the Committee on Accounting Research of The Dominion Association of Chartered Accountants.

IT IS generally realized by the members of the accounting profession, the taxation authorities and the investing public that the substantial accuracy of the operating results and financial position of companies as shown by statements of Profit and Loss and Balance Sheets is largely dependent upon the soundness of the basis followed in valuing the stocks on hand of raw material, work in progress and finished goods. For this reason our readers should be interested in reading the excellent study of this subject by C. B. Wade, C.A., and J. E. Ferguson, B.Com., of Queen's University, Kingston, which is published in the current issue of THE CANADIAN CHARTERED ACCOUNTANT.

Among other features the study brings out, firstly, that the large majority of the 202 public companies whose annual reports were reviewed describe their inventories as valued at the "lower of cost or market" and that the large minority make use of the term "cost;" secondly, that there are at least two meanings of the term "market"—one, that it represents "replacement cost," and two, that it represents "selling price." It would seem to be a matter of considerable importance that this uncertainty as to the meaning of the accounting term of "market" so frequently employed should be removed, and with that in view the suggestion is made that the appropriate committees of The Dominion Association of Chartered Accountants should study the matter.

It is a fundamental in the pricing of inventories that they should never be valued above cost. There would seem to be little room for any difference of opinion on the point that the best comparisons of operating unit costs and profits are obtained when determined on the basis of actual costs first, and introducing as a separate item a provision for any actual write-down to market of raw material or product below cost, or a reserve to meet depreciation in the value of such items. The general practice in Canada is not to show the amount of inventory reserves but to report the amount of the inventory at the net value as determined. It is believed that the practice in this respect would be im-

proved by showing on annual balance sheets the amount of the inventories both before and after deducting any unapplied reserves.

Generally inventories should be valued on the basis of the lower of cost or replacement cost, or the lower of cost or selling price (net)—i.e., after providing for selling and shipping expenses and a margin for profit. In certain businesses it is impossible or impracticable to determine accurate unit costs of products and by-products, or perhaps to ascertain more than the approximate cost of the stocks on hand. In all cases there are at least two features which should be covered in the description of the item in the balance sheet:

Firstly, the basis of valuation should be explicitly (not implicitly) described;

Secondly, whether the valuation is made in accordance with the company's usual practice.

In connection with the description of the basis of valuation it might be worth while considering whether to discontinue using the term "market" and to substitute for it either "replacement cost" or "selling value" depending on which term fits the particular case.

D. McK. McClelland.

**PRESIDENT M. C. McCANNEL ADDRESSES OTTAWA
CHARTERED ACCOUNTANTS***

Mr. Chairman, Gentlemen:

It is quite an honour to be invited to such a gathering as this. I would like to express the appreciation of The Dominion Association of Chartered Accountants in that you have invited our Secretary, Mr. Carr, and myself, as President to be your guests. The people of Eastern Canada, and especially those in Ottawa, have opportunity of hearing so many good public speakers that it is quite a task for the rest of us to prove even interesting.

We should all take our positions very seriously, but not ourselves. W. L. Brockington, while city solicitor of Calgary, told the story that one day while walking down the streets in Calgary he met a drunken lawyer from Medicine Hat who asked him if he knew how far it was to the moon to which he answered, "No." He was told how many million miles it was. Then he was asked how many million miles it was to the sun from the moon, and was again told. He was informed that there were stars many million miles beyond that. Then he was told to consider all this and then consider how important was the city solicitor of Calgary. One good thing is that I have no reputation as a speaker to live up to, and perhaps it may be a good thing in Ottawa to have none to live down.

At chartered accountant meetings all are present to arrive at the correct solution to all problems discussed, and each one is willing to accept the other man's solution if it is a better one than his own. It is much like the old western custom of parking all guns at the door before going in to the meeting.

Development of Dominion Organization—At one time in Canada there were two groups of chartered accountants. One group had an Act of Incorporation granted by the Dominion parliament in 1902; the other was composed of those holding Provincial charters. The Provincial groups restricted admission to those who passed their respective examinations. The Dominion group admitted men who had

*An address by the President of The Dominion Association of Chartered Accountants given at a dinner at Ottawa of the Chartered Accountants' Group of the Professional Institute of the Civil Service of Canada, Monday evening, 2nd March 1942.

been in public practice for some years upon vote of the council and the payment of the admission fee. There was provision in the Dominion charter to admit those from the provincial bodies if they applied for admission within one year of the forming of the Dominion Association.

The Provincial bodies were concerned over these two methods of admittance and the divided groups with the same appellation or title "chartered accountant." Finally in 1910 the Dominion and Provincial groups joined, admitting to full membership the members of the Dominion body into the provincial body with which they wished to become affiliated. The Dominion charter was retained and the total membership of the Dominion Association is now composed of the members of the several Provincial Institutes. Those who joined the Provincial bodies were accepted with absolutely no separation from those already admitted. The Dominion members admitted were most worthy members, and worked faithfully in the respective Provincial Institutes for the upbuilding of the profession. Some have since been made Fellows of their Provincial Institutes and this honour entitles them to use the designation F. C. A.

An Institute in Each Province—The Provincial Institutes or Associations are incorporated in each of the nine provinces. Since the war, I believe, all the members of the Prince Edward Island Institute ordinarily resident in that Province are away on war work. Each Provincial Institute has its own officers and council and conducts its own provincial affairs entirely uncontrolled by the Dominion Association except for voluntary co-operation. According to the *British North America Act* all matters of education belong to the provinces. Thus matters of educating the students and holding of examinations are operated under the direction of the different Provincial Institutes. Up to a few years ago each province conducted its own examinations entirely. Then after considerable research it was agreed to have one examination committee for the whole of the Dominion. Each Provincial Institute now accepts the examinations as prepared by the central examination committee as its own examination. In most of the provinces the correspondence course of the Ontario Institute, which is administered by Queen's University, is used for the in-

struction of students with the permission of the Ontario Institute. In British Columbia a course of lectures is, in addition, given to students. In Manitoba a very effective course of studies is carried on with considerable supervision of the students.

Permanent Secretariat Established—The work of the Dominion Association has increased very rapidly and the necessity of continuous Dominion activities made it necessary in 1931 to have a permanent secretary. We were fortunate in the choice of our first secretary, who has proven to be a highly efficient factor in the increase in the effectiveness and professional standards of the Dominion Association. We still have him in the person of Mr. Carr, who is with us tonight. The Dominion Association forms a clearing house as between the different Provincial Institutes, and is thus able to aid in bringing about uniformity of the provincial bodies.

Reciprocity Between Institutes—At present five Provincial Institutes have provided for admission to membership from other Provincial Institutes without the payment of any admission fee, provided the Institute from which the member comes extends the same privilege to the members of the Institute in which he is seeking membership. Further study in this matter is taking place to see if some common ground can be arrived at wherein this condition of affairs may apply as between all the Provincial Institutes.

Members and the War Effort—At this time of world war there is much discussion as to how best Canada can conduct her part, and as to the place of the individual in this set-up. This applies particularly to chartered accountants, as their specialized training makes them valuable men in so many different phases of our country's effort. There is the direct war participation by those physically fit. There are the governmental requirements largely concerning the enactment of the different regulations brought on by the war. Then there are the different manufacturing and trading operations privately carried on which require audited statements.

A considerable number of our members are now in His Majesty's Forces and an increasing number are entering

the government services as evidenced by the number here tonight. The remainder are carrying on with reduced staffs the increasing work of the profession in private industry.

Our Dominion Association, through its Legislation and War Services Committees, has worked in close co-operation with our government officials. Our Association is concerned only with that which will be for progress in our country, and not to further the interests of any individual or party. The unselfish, valuable service rendered by our representatives has raised the standard of chartered accountants in the minds of our legislators. Not long ago it was stated that in the event of a disagreement as between Dominion and Provincial governments, the matter in dispute should be referred to a "chartered accountant." Some provinces, in signing the agreement, changed the words "chartered accountant" to "qualified accountant," which is a very general term with various interpretations.

Profession Held in Esteem—The work of the chartered accountant has been carried on in public practice and also in government and private service in such a manner that the name stands for the highest in accounting practice. A wonderful heritage has been handed down to us by those who have gone before. It remains with us to so carry on that these standards will be higher than when received by us. Our profession cannot be likened to a chain with strong and weak links, but to a rope with many strands of various strength bound together to produce one strong whole.

Our profession is well known not only in Canada, but in the United States of America as well, where our representatives are welcomed at each of the annual meetings of the American Institute of Accountants. At the last annual meeting of our Association, the President of the American Institute accepted an invitation to be present, but before leaving for the gathering was suddenly taken to the hospital. The Institute thought so much of their Canadian relations that they sent the man who was to be their incoming President to be their representative. Our Secretary and I were present as guests of the American Institute at Detroit last fall. It was a great convention with over twelve hundred registered in attendance. Greatest interest was taken in taxation matters. Several of the officials of their Institute are chartered accountants with membership

in different Provincial Institutes. The address of Mr. George McDonald of Montreal, giving the place of chartered accountants in Canada's war effort and Canada's part in the war, was eagerly listened to and much appreciated.

Last summer we were invited to send a delegate to an accounting meeting in Buenos Aires. Mr. R. Sneath, a chartered accountant resident in Buenos Aires, kindly represented our Dominion Association at that meeting.

I would also like to state that each member of the English, Scottish, or Irish Institutes who comes to Canada to make his home here and to enter public practice has always affiliated with one of our Provincial Institutes. These men have contributed well to the work of the profession in Canada, and many have been elected to the council of the Dominion, and to those of the Provincial associations.

Responsibilities of Chartered Accountants—The only privilege granted by the charters of the Provincial and Dominion Associations is the right to use the name "Chartered Accountant," and the letters "C.A." All rights, or the standing of the appellation has been obtained by the class of work done by those holding the title "chartered accountant." Now that such previous efforts have built up the present standing to where such confidence has been placed in us, the responsibility resting upon you and me is greater than ever before. "To whom much is given, much shall be required."

There is a normal impulse in each of us to correct error and protest against wrong whenever we see it. We must be careful, however, that our efforts to change conditions and promote the common welfare are in harmony with fundamental principles. For that reason I am pleased that so many chartered accountants are in the government service where their training and ability will be directly available when changes are being made.

Experience teaches that the welfare and progress of society are dependent on the continued improvement and enlargement of its equipment of productive property at a rate which will not only overcome the natural disadvantages under which an increasing population labours in obtaining substance from the resources of nature, but actually yielding a considerably increased supply of comforts for each head of the increasing population. The demands of war mean that civilian production is materially reduced to

make way for the necessities of war. This means an increasing governmental supervision to see that the reduced production for civilian use is properly distributed. In this work a large number of you now have a part.

I have tried to give you a picture of the Dominion Association to which you all belong. You are doing your part well. I trust that you will have much success in the work of your group in the Professional Institute of the Civil Service of Canada. I would, also, ask that you keep in close touch with the work of the Provincial Institute to which you belong in order that you may contribute to the continued advancement of the profession.

I thank you again for your courtesy in having us with you, and wish to express our pleasure at this opportunity of meeting you.

SOME OBSERVATIONS ON THE PROFESSION*

**By Austin H. Carr, Chartered Accountant
Toronto**

Mr. Chairman and Members:

It is a pleasure to be present at so large a gathering of the members of our profession engaged regularly in the Civil Service and in the war activities of the Government. I am particularly happy that our President is able to be with us tonight and to bring a message from the Dominion Association. Mr. McCannel and I have something in common. He has lived in Alberta for thirty years. I was there from 1909 to 1922, and the Alberta Institute of Chartered Accountants is my home Institute. Anyone who has resided in that province for a decade or more can never forget its spaciousness and the grandeur of the Rockies.

I shall try to be as brief as possible, Mr. Chairman. That reminds me of the story of the ambitious social-climbing wife of a merchant. On returning from a party one afternoon she remarked to her husband: "Do you know dear, I had a vocabulary test this afternoon, and I find that I have a vocabulary of only about 500 words?" The merchant

*Made at a dinner at Ottawa of the Chartered Accountants' Section of the Professional Institute of the Civil Service of Canada, Monday evening, 2nd March 1942.

who thought only in terms of merchandise said: "Yes, my dear, your vocabulary appears to be small, but O heavens, the turnover!"

For the past eleven years I have talked to you through the editorial column of *The Canadian Chartered Accountant*. Tonight I meet you face to face and can be a little more personal than is possible when speaking to 4,000 or more subscribers to our Magazine.

I have wondered what sort of a patchwork quilt my comments over the years would make if each discussion had its distinguishing colour. Although I have received letters at times saying that the writers were glad that we had come out flatly and said what was needed to be said on a subject, I think that that patchwork creation would not have many of the red spots of the rebel. Possibly the reddest would be the comments of about two years ago when we made bold to discuss Dominion income tax administration and to say some things that needed to be said. The exclamations of horror of some members at our intrepidity in criticizing such an august body turned later to words of approval. In keeping with the dignity of the profession that quilt would probably be for the most part of pastel shades.

Tonight it is different. Here we have a number of live members of the profession formed into a body for a definite purpose. We can be a bit more pointed in our remarks. I have read again the objects of your organization as you had me publish them in *The Canadian Chartered Accountant*. What impresses me most of all is your programme of instruction and the formation of discussion groups. Here are laudable aims indeed. The energy that each individual will put into that programme will determine the success or otherwise of your organization.

A Profession of Progress

From my point of vantage at this table I observe that the majority of the group assembled here tonight are the graduates of the more recent years of the Institutes. Others of us, who can look back twenty years or more, can see a tremendous advance in the status of the professional accountant. The stages in that progress stand out clear and are distinctly marked. Our legislatures with their numerous enactments governing the conduct of business and the

taxing of income have done more than any other agency to encourage that leap forward.

The function of the public accountant as a checker and auditor has taken a secondary position. The chartered accountant has been thrust into situations that have proved his resourcefulness. Above all they have demonstrated the significance and worth of his rigid preparatory training and education. As one observer recently put it, the members of our profession are recognized as the chief arbiters of probity in our commercial and complicated financial relations. They are being asked more and more to act as umpires between interested parties. They have become the consultants in industry.

If a member of our profession of thirty years ago should step into the complex practice of the chartered accountant of today, he would be like Rip Van Winkle returning to his native village; it would be a case of complete bewilderment. That does not mean that we have reached the apex of accomplishment. Our profession is not static. Inertia must not become a part of our nature. If we of today could get a glimpse of the profession as it will be existing thirty years hence, we most surely would find advances just as marked and just as bewildering as those of the past quarter century.

I recall a lecture given once by the late Lord Stamp (then Sir Josiah Stamp) to, I think, a body of accountants in the United States. He made the observation that members of our profession from their daily contact with the records of the commercial transactions of the nation were in possession of facts and figures of profound importance. But to his regret, he said, he was forced to make this further observation: Of the significance of these figures in the study of scientific progress in industry the accounting profession was unfortunately almost wholly ignorant. Such an accusation brings to one's mind the picture of a child tumbling about a huge horsepower engine and unaware of its potentialities, or of the lonely homesteader in the Turner Valley of Alberta thirty or more years ago never dreaming that under his acres prodigious stores of gas and oil were only awaiting the exploiter's drill to benefit the nation.

The Dominion government has made pressing demands upon our profession during the present crisis. To a group

of the younger members belongs the credit of putting into operation the rules and regulations of the Foreign Exchange Control Board which was set up immediately on the outbreak of war in 1939. I shall not enter into details of the work of our members in other departments of the government; you are familiar with the capacities in which they are serving with credit to themselves and to The Dominion Association of Chartered Accountants. But I do not want to let this opportunity pass without mentioning particularly the services of Mr. Henry Norman in the Commonwealth Air Training Plan and the contribution of Mr. Maxwell Henderson to the successful functioning of the Wartime Prices and Trade Board.

The members of this profession have demonstrated that they are capable of still greater things. The need of the scientific approach to problems is being brought home to the industrialist and the controller of business today more forcibly than ever before. As Lord Stamp observed on another occasion, the validity of incremental changes of science in industry is dependent on very exact accountancy measurements. And in this connection he made a statement that should bring every wideawake accountant to his feet: "I do not think it too much to say that in industry today scientific progress can only show itself through the language and the verdict of the cost accountant; and accountancy, as a language of scientific evidence, is only in its infancy."

Responsibility on Individual

That is the picture of the profession, Mr. Chairman, that I want to bring to all of you gathered here tonight. The progress of our profession today and in the days following this war is in your hands and in those of members in other parts of the Dominion. In the last analysis that progress will be determined by the thought and the actions of the individual member. Many of you must be making a study of problems which you have met and continue to meet in your everyday work or practice. For those in the income tax division in particular such instances or occasions must be many. On behalf of the Editorial Committee of our professional journal I ask that you send me the product of your researches and the results of your studies for publication in *The Canadian Chartered Accountant*.

Those of you who are interested in investigation work realize that the conclusions of a research study are not prepared in a single day. The essay or report is the accumulation of days and nights of thought and study. You have also discovered the advantage of reviewing the manuscript at intervals. You are surprised at the new slants on things that come to you. This goes to prove that while you are engaged in other activities your subconscious mind is ever busy weighing what has already been set down and preparing the way for the final conclusions of your studies.

We are all human, and the chief aim of all of us is to earn a living for ourselves and our family. Here is an aspect of your professional efforts that I am surprised has not occurred to more members who act as assistants in various capacities and who at time become concerned over the amount of the salary being paid you. It is a practical application of the truth that a light is not to be hidden under a bushel but set on a candlestick.

I recall one instance in particular of a young member sending in to us a series of articles which were the results of studies he had made in a special field. He most likely, above all others, got the greatest benefit from those investigations. However, the point I wish to make is that on publication in *The Canadian Chartered Accountant* they came to the attention of the management of a large company. After an exchange of correspondence the young man was offered a responsible post with the firm. It was accepted, and the consequent advance in salary came because of merit.

It is surprising what can be accomplished when a real effort is made. The participation of our members in the wartime activities of the government and of industry has demonstrated what tasks chartered accountants can undertake and the programmes they are capable of bringing to a successful conclusion. Have you not noticed that those taking the most active part in the affairs of the Institutes and of the Dominion Association are extremely busy men of the profession? Here is a lesson for those of us who think we "have no time." It was the eminent Divine, Phillip Brooks, who once made the observation: I ask not for work

equal to my strength, but I ask God for strength sufficient for my work.

Those are a few thoughts I leave with you tonight. And I want to add that the members of our Editorial Committee invite you all to give them an opportunity to help both yourselves and the profession in the way I have suggested.

TAX CONVENTION BETWEEN CANADA AND UNITED STATES

THE following is the text of the announcement made in the House of Commons, Ottawa, 5th March last by Honourable Colin Gibson, Minister of National Revenue:

A tax convention was signed at Washington on the 4th day of March between Canada and the United States for the equalization of tax deductions at the source, for the avoidance of double taxation, for the prevention of fiscal evasion and for the general promotion of the flow of commerce between the two countries.

This convention follows along the lines of the previous convention which existed from, and during, 1936 until April of 1941.

Deduction at the source in the United States was increased in 1941 to 27½ per cent on dividends, interest, rents, royalties and other periodic payments coming to residents in Canada. The present convention reduces this to 15 per cent as and from the first day of January 1941. Canada also deducts 15 per cent in respect of interest, dividends and royalties going to the United States, so that there now exists substantial equality of deduction at the source between the two countries.

Individuals, resident in Canada, who are not citizens of the United States, are not subject to the graduated rates of tax in the United States and are not required to file United States returns, unless they have an office or place of business therein.

For parent companies in Canada, receiving dividends from wholly-owned subsidiaries in the United States, the tax deduction at the source is reduced to 5 per cent. Dividends from Canadian subsidiary companies are, as hereto-

fore, transmitted to parent companies in the United States free of any tax deduction at the source, but the Canadian government will be free to tax these dividends as it chooses, at a rate not exceeding 5 per cent.

As the convention comes into force on the first day of January 1941 a refund will be made of all taxes deducted at the source in excess of the said 15 per cent or 5 per cent rate, without application being made therefor, as the refunds will be made by direction of the government of the United States through the medium of corporations and institutions which initially made the deductions.

The convention shall remain effective for a period of at least three years in respect of all its features, and continuously beyond the three years until at least six months' notice of termination has been given by either country, in which case the termination becomes effective on the first day of January following the expiration of the said six months' period.

However, after the fixed period of three years, the rate of 15 per cent may thereafter be altered without notice and without affecting other parts of the agreement, as it was felt that neither country wished to preclude a change in the tax rates at any time, if a subsequent parliament or congress desired to change them.

Canada for some time has been making representations in connection with tax claims raised by the revenue authorities of the United States on profits or gains made by Canadians trading in securities and commodities in the United States. The tax was claimed, even though in subsequent years losses were sustained which more than offset the prior years of profits on which the tax claim was based. While the profits were in hand, Canadians had no knowledge of their liability. In fact, there was a general belief that no such liability could be raised or would be raised.

Now by reason of this convention, all such persons may effect a settlement with the United States revenue officials on a basis of paying 5 per cent on the dividend and interest yield received by such investors in the years during which they held the securities, provided they file a request for settlement with the Commissioner of Internal Revenue, Washington, within two years from the date of signature

—not the effective date—of this convention. Otherwise they will not receive the benefit of this convention.

This is in effect a change from a capital gains tax to a 5 per cent deduction at the source, based on net revenue, if any, received from such securities.

Capital gains by Canadian residents derived from sources within the United States shall not be subject to tax therein, provided such Canadians have no permanent establishment in the United States.

There are certain extra-territorial features of the revenue laws of the United States, included not only in the 1941 act but in prior acts of that country, which impinged upon any Canadian company if 50 per cent or more of the income of the Canadian company were derived from sources within the United States. These extra-territorial features also impinged upon such Canadian company paying dividends to a Canadian resident, and also upon any such Canadian company accumulating undistributed income.

These are technical in character and the technical features need not now be mentioned in this general announcement. Those particularly interested should refer to the terms of the convention itself.

All these extra-territorial features, so far as Canadians, and Canadian-controlled companies, are concerned, have been eliminated by the terms of the Convention.

Charitable organizations are exempt from deduction at the source, if the organization is a charitable organization within the meaning of the laws of each country, when read together. If a charity is such within the meaning of the United States law only, the terms of which perhaps are a little wider than the Canadian definition of charity, but is not a charitable institution within the meaning of the Canadian law, then the deduction at the source would not be waived. The charitable organization must be such within the meaning of our law as well as within the meaning of the United States law.

All persons in the employ of the dominion or provincial governments, or any political subdivision, agency or instrumentality thereof, whose duties require them to reside in the United States are to be taxed by the Canadian government, while like officials of the United States government, or any political subdivision, agency or instrumentality

thereof, residing in Canada and paid from the United States are not to be taxed in Canada.

On the other hand, pensions shall be taxed in the country where the recipient resides and not in the country where the pensions arise. Life annuities also will be taxed only in the country where the recipient resides.

Each country will refrain from taxing any person from the other country, in respect only of compensation for labour or personal services, if such person—

- (a) remains for a period or periods not exceeding 183 days, and
- (b) receives \$5,000 or less in the aggregate during such stay; or
- (a) remains for a period or periods not exceeding 90 days, and
- (b) receives \$1,500 or less in the aggregate during such stay.

This is intended to exempt a number of persons who are for a short time in industrial activities, but the convention by special mention does not grant exemption in respect of professional earnings such as those received by actors, artists, musicians, and professional athletes who are taxable in the country in which they exercise their skill.

The income derived from the operation of ships or aircraft shall be taxed in the country of registration.

Students or business apprentices are exempt from tax in the country in which they are studying in respect of remittances received by them for the purpose of their maintenance or studies.

Any actual case of double taxation within the purview of this agreement, and not otherwise dealt with, may be dealt with by consultation and appropriate adjustment between the countries.

Each country undertakes to supply the other country with information in respect of dividends, interest, rents, royalties and other periodic payments passing from one to the other.

There is provision in special cases, and at the request of either government, for consultation where the authorities of one country might desire information in respect of any particular taxpayer's activities in the other country.

Finally, there is provision for equality of treatment, namely that the citizens of one of the contracting states residing within the other shall not be subject to the payment of more burdensome taxes than those which are borne by the citizens of the other contracting state, or in other words, citizens of the United States within Canada are not to be discriminated against by more burdensome taxation than that imposed upon our own citizens within Canada.

It should perhaps again be stated that all moneys that have been deducted and collected at the source under the 16½ per cent rate that arose immediately after the repeal of the former convention on the 29th April last, and all moneys collected under the 27½ per cent rate as provided by the 1941 United States revenue laws, are to be refunded to Canadian residents to the extent that they are over the basic 15 per cent or, in the case of parent companies, over the 5 per cent rate now agreed upon, without application having to be made therefor. Hereafter, only 15 per cent will be deducted.

From a reading of the convention, it will be realized that this is probably the most extensive fiscal convention that has yet been entered into on the subject of direct taxation. It is tangible evidence of the growing intimacy between Canada and the United States.

GLIMPSES OF CURRENT ACCOUNTING LITERATURE

A Summary Prepared by John Douglas Campbell,
Chartered Accountant

BULLETINS

(1) Cost Accounting

BULLETIN No. 11, Volume XXIII, 1st February 1942, published by the National Association of Cost Accountants is devoted to a discussion of production control.

Herbert J. Myers in an article "Coördinating Material with Production Needs" outlines the means, methods and records needed for a proper coördination of all the functions and facilities of production, necessary for proper inventory control. "Material control in its widest sense means coördination."

A short concise survey is given of a typical production method which starts from the point of design and the development of a bill of material and then passes over to the sales budget. The sales budget acts as the production release indicating the number of each product which is to be manufactured, the rate per day, week or month. When this point has been reached the one remaining difficulty is to build up records such as to provide "the right material in the correct quantity, in the right place at the time it is needed." In dealing with this problem four basic requirements are set out as to what the records should reveal for every item of material or part. "1. What are the total needs for each item to complete the production authorized? 2. How many have been covered by purchase orders? 3. On what dates are they due in our plant and how many are due on each date? 4. How many have been received to date?"

The final portion of the article consists of a case problem indicating the concrete application of the means, methods and records discussed in the first part of the article.

Bulletin No. 12, Volume XXIII, 15th February 1942, covers in its first article a discussion of the influence which various governmental agencies have had in the field of general and cost accounting. The second article deals with the place of reporting in cost control.

Maurice E. Peloubet in the article "Trends in Accepted

Accounting and Their Relation to Cost Accounting," discusses the effect which the various governmental agencies in the United States—the revenue laws, the Securities and Exchange Commission, and national defence—as well as certain other agencies in the form of stockholders' requests for information and demands arising from the interrelationship existing between general and cost accountants have had upon both general and cost accounting.

The article is primarily devoted to the governmental agencies of revenue laws and national defence. The influence of the revenue laws is indicated as good in so far as it has placed a premium on the presentation of correct accounts, and as undesirable, particularly in the cost accounting field, "in the direction of reducing depreciation allowances and eliminating or cutting down to a large extent allowances for obsolescence." In referring to the present defence program as an agency, it is stated that it "is the strongest single influence which affects accounting generally and cost accounting in particular." Certain specific aspects of the defence program are considered, e.g. costs and their relation to the different types of contracts.

The article is climaxed by a short discussion of the part which accountants in general are being called upon to play in the present emergency and the part which they will be called upon to play in the "inevitable readjustment which will follow."

Glenn R. Kleinau in an article "Figures for Management" presents certain basic standards of measurement by means of which the accountant might measure the adequacy of the information which he is presenting to executives.

The basic standards of measurement which are outlined and illustrated consist of three principles and five questions. The principles cover the nature of the information to be presented. This information should be related to the activities of individuals and broken down in relation to the factors which make up the situation. It should be such as to enable the executive to base his action upon it. The questions cover the manner in which such information is to be obtained.

(2) Accounting Research

In January 1942 the committee on accounting procedure of the American Institute of Accountants issued

Accounting Research Bulletins Nos. 13 and 14 and these are reproduced in the February 1942 issue of *The Journal of Accountancy*.

Bulletin No. 13, "Accounting for Special Reserves Arising out of the War," has been drafted "to present recommendations for meeting war conditions in a manner consistent with accounting principles previously established."

A distinct classification is first made as to the nature of the special war reserves and upon this classification is based the suggested accounting treatment. Two main classes of special war reserves are set out, "(a) those reserves or parts of reserves which must be provided in order to conform to accepted principles of accounting, and (b) those additional reserves or parts of reserves created in the discretion of management as a matter of conservative business administration but which are not presently determinable within the limits necessary for definitive accounting statement."

In the case of reserves falling under the first classification the suggestion is made that they be provided by charges in the current income statement to the extent that they can be measured and allocated to fiscal periods with reasonable approximation. "The charges for which the reserves have previously been created should be applied against the appropriate reserves and any unused portion thereof should be dealt with in accordance with general practice relating to corrections of estimates made in prior years."

Those reserves falling under the second classification of "conservative business administration" should be provided for "in the income statement as a deduction from the income for the period computed on the usual basis" (equity reserves). When the costs or losses are finally determined it is suggested that they be brought into the income statement but in such a way as not to obscure the results for the period then current. Where the amounts of such reserves are relatively large, the facts should be revealed in such a way both at the time the reserve is created and when the costs and losses are determined as to leave no doubt as to the nature of the items involved.

The creation of reserves for equalizing reported income is not sanctioned and, where such reserves are created by

charges against earned surplus, operating expenses should not be sidetracked as charges against such reserves when they are properly chargeable against the revenue of the period.

Bulletin No. 14, "Accounting for United States Treasury Tax Notes," deals with the reporting of United States treasury tax notes in the balance sheet of the purchaser.

Treasury tax notes (U.S.A.) are issued under a "Tax Savings Plan" by means of which taxpayers may purchase notes while income is accruing for use as a medium of payment of the income and excess profits taxes subsequently falling due.

As the purchase of such notes is in reality a temporary investment at a low yield in securities which are designed to be used as tax paying media, they should be treated as any other temporary investment, namely, as a current asset. The fact that some purchasers view the transaction as an advance payment of tax makes it permissible and in accordance with good accounting practice where such intent exists "that the notes be shown in the current liability section of the balance sheet (to the extent of the accrued liability for such taxes) as a deduction therefrom. The full amount of the accrued liability should be shown with a deduction for the tax payment value of the notes at the date of the balance sheet."

(3) Auditing Procedure

Statement No. 9 on Auditing Procedure, "Accountants' Reports on Examinations of Securities and Similar Investments under the Investment Company Act," was issued in January 1942 by the committee on auditing procedure of the American Institute of Accountants. The statement and the related release to which it refers, which was made by the Securities and Exchange Commission, are published in the February 1942 issue of *The Journal of Accountancy*.

Although the statement refers specifically to the interpretation placed on certain auditing requirements set out under the Investment Company Act of 1940 (U.S.A.) certain features of the interpretation do carry some interest for auditors in general.

The interpretation placed on the requirements of a "complete examination" by the chief accountant of the Securi-

ties and Exchange Commission calls for the necessity "in addition to making physical examination or confirmation of the securities and reconciling them with the books, of making an appropriate examination of the investment accounts and supporting records, including an adequate check or analysis of the security transactions since the last examination and the entries pertaining thereto."

ARTICLES

(1) Inventory Pricing

A report made by a committee of the American Institute of Accountants to the taxation committee of the National Dry Goods Association, which is published in the February 1942 issue of *The Journal of Accountancy*, sets out a discussion of the last-in, first-out basis ("Lifo") of inventory pricing as applied to retail establishments with specific attention to the advantage claimed for the use of the "Lifo" method.

A short discussion is first presented as to the nature of the three main bases of inventory pricing: first-in, first-out; last-in, first-out ("Lifo"); and normal stock method. "The retail method of inventory is essentially a first-in, first-out basis (using averages) under which the inventory is priced at approximately cost or market, whichever is lower, and not at cost." This is followed by a statistical presentation comparing the application of the retail method of inventory pricing (first-in, first-out) as against the last-in, first-out method as applied to retail stores in an effort to determine the significance of the advantages claimed for the utilization of the last-in, first-out basis.

The conclusions which are drawn are essentially (1) that profits determined on the basis of last-in, first-out inventory valuation are no fairer than those determined on the retail inventory basis, (2) that whether or not the income tax payments over a cycle will be lower by using the "Lifo" basis will depend upon the trend of price indexes and tax rates, (3) that approximately higher selling prices and hence higher profits may result from the use of the "Lifo" basis is doubtful. "It is still a question . . . whether a similar result cannot be obtained under present methods without the confusion of change."

(2) Prepayment of Tax Liability

In light of bulletin No. 14 issued by the American Institute of Accountants covering the accounting for treasury tax notes, it is interesting to note that certain Canadian companies on their recently published balance sheets note specifically the prepayment of a portion of their tax liability.

The following extracts are taken from the published balance sheets of the companies indicated.

Canada Cement Company Limited
(30th November 1941)

Provision for Dominion, Provincial and other Taxes (after prepayment of approximately \$1,000,000.00 to the Dominion Government)	\$.....
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Hinde and Dauch Paper Company of Canada Limited
(31st December 1941)

Accrued Income Taxes (Less Prepayments \$160,000.00)	\$.....
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Gypsum, Lime and Alabastine, Canada, Limited
(30th November 1941)

Dominion, provincial and other taxes (estimated) \$.....	
Less: paid on account of 1941 Dominion in- come tax

(3) Income Determination

Reuel I. Lund in an article "Realizable Value as a Measurement of Income," published in the December 1941 issue of *The Accounting Review* (Chicago), discusses the question of income determination at the point of completion of the productive process and the circumstances under which such a basis would be tenable.

Six desirable qualities are outlined as being correlated with income recognition which are applied to particular sets of circumstances in determining whether or not income has been realized. Certain specific cases are cited (agricultural and extractive industries) where the qualities outlined are considered to be satisfied at the completion of the productive process and it is argued that under such circumstances income should be recognized at the completion of the productive process rather than at the point of sale. The main advantages arising from the immediate recognition of income under such circumstances are set out covering the

question of the proper disclosure of income earned from operations and the possible separation of income as between production and speculation.

Specific examples are discussed. These are taken from actual practice and embrace products chosen from both the extractive and agricultural industries, the more important products considered being gold, silver, sugar and petroleum.

"Where there is a ready market for the product of a company and the company's production is not so large that its selling operations will seriously affect the price quotation, then a measurement of income is available as soon as the product is ready for marketing."

PROVINCIAL TAXATION

FOR our information, we have received copies of the provisional tax agreements between the Dominion government and the Provinces. These agreements are under discussion at the present sessions of the Provincial legislatures, but the provincial secretaries have not yet been able to send us copies of legislation in its final form to implement such agreements. For instance, the Deputy Provincial Secretary-Treasurer of New Brunswick in a letter of 17th March stated that a bill before the Legislature there provides for the temporary suspension of the imposition of income taxes, corporation taxes and taxes on securities. When the bill is passed, the Province will not be collecting income or profits taxes beyond the period ended 31st December 1940.

The Deputy Provincial Treasurer of Ontario on 16th March kindly supplied us with a copy of the agreement between the governments of the Dominion and Ontario which will form the basis of legislation shortly.

In general, the Province of Ontario will collect the income tax on income of the calendar year of 1940 and prior years and any arrears thereof but will not levy taxes on income of the calendar year 1941 and subsequent years during the term of the agreement. In the case of any tax on income of a fiscal period of a taxpayer ending in the calendar year 1941, the Province will collect that proportion of the tax which the number of days of such

fiscal period in the calendar year 1940 bears to the total number of days of such fiscal period, and that proportion of the tax which the number of days of such fiscal period in the calendar year 1941 bears to the total number of days of such fiscal period shall not be levied or collected. The Province will refund to taxpayers any income taxes heretofore or hereafter collected on income of the calendar year 1941, or if any fiscal period of a taxpayer ends within such calendar year the Province will refund to taxpayers that proportion of the total tax which the number of days of such fiscal period in such calendar year bears to the total number of days of such fiscal period. The Province will collect the corporation taxes, other than income tax, which became due and payable on or before first September 1941.

Definite particulars will be published in these columns as soon as the statutes become available.

ECONOMIC NOTES

Balance Sheet of Aggression

Editor's Note: This is another in a series of notes on current economic subjects by Lawrence B. Jack, M.A., Montreal.

IN the early stages of the war a favourite pastime of arm-chair strategists was to tot up the resources exploited by the Allies, or available to them owing to their control of ocean routes, and then point with pride to their overwhelming superiority to similar resources available to the Axis. At best this was merely waste of time; at worst it fostered complacency and the ill-founded belief that the Axis would fold up as the result of sheer weight of blockade. It should have been evident that crude steel capacity and endless miles of automobile assembly lines would be of no military use until they were combined and translated into production of, say, tanks. Now it is only too painfully evident that even the wealthiest country must devote at least half of its productive powers to its war effort if it is to match the exertions of the totalitarian states.

Because the Allies were slow to believe that their war effort could not be painlessly superimposed upon the production necessary to maintain their comfortable peacetime standard of living, successful Axis aggression has gone a long way toward redressing the unbalance of the world's

ECONOMIC NOTES

resources which had tilted so heavily against them in 1939. The accompanying table shows the effects on supplies of selected raw materials which resulted from the Jap outbreak. Since the military experts warn us to expect a German drive to bottle up the Middle East, and further Jap advances designed to choke off productive resources in the Pacific and India, it has been further assumed that these areas will be lost, at least temporarily. For once we may be permitted to proceed on the assumption that the worst will happen; we will then have cause for rejoicing if we experience any lesser evil. Finally, Western Hemisphere production has been given to indicate approximately the likely effects of further destruction of Russian productive capacity.

United Nations' Control of Raw Materials*

AFTER DEDUCTING FOR

	Before 7th Dec., 1941	Jap Conquests to 15th March 1942	Also: China, India and Australia	Also: Egypt Turkey and Mid-East	North and South American Production
Sugar	73%	61%	46%	46%	35%
Cotton	92	92	76	67	54
Wool	87	87	48	46	27
Rubber	97	3	3	3	2
Copra	98	11	2	2	0
Manganese	87	85	68	66	6
Tungsten	88	84	23	23	21
Chrome	92	86	76	58	6
Bauxite	45	38	37	37	31
Tin	90	31	28	28	17
Lead	76	76	58	58	54
Zinc	74	74	60	60	53

It should be emphasized, of course, that the Axis nations will not necessarily be able to make immediate (or any) use of conquered resources. If we assume that a scorched earth policy is carried out, they will gain very little, but they will emphatically reduce the United Nations' war potential by their advances. Further, it must be assumed that when territory is re-won by our side production facilities will be even more efficiently ruined by the retreating enemy than they have been by us. After all, he will have no qualms of ownership to induce him to stay his hand. It is therefore cold comfort to say, no matter how truthfully, that scorched earth tactics have robbed the enemy of the chief fruits of aggression.

*Source: *Moody's Stock Survey*, 23rd February 1942—revised.

Moreover, it will not be necessary for Japan and Germany to occupy the Mid-East, Australia, India and China in their entirety to injure the Allies effectively. If they can successfully blockade these areas—as Japan already has done in the case of China—their aid to our war production in the form of raw material supplies will have been destroyed as effectively as if full occupation were a fact. For this reason heavy sacrifices will be well repaid if they are successful in limiting or completely frustrating aggression in these areas.

Developments to date have made it very obvious that the Allies must now depend far more upon their own resources than they had ever dreamed would be necessary only four months ago. In fact, the effort merely to hold their current superiority in and access to many raw materials will constitute a great strain. With respect to rubber, tin and copra their ingenuity to develop substitutes on the requisite scale will be mightily exercised. In the case of copra (an important element in soap-making), supplies can be developed in the Western Hemisphere, but only slowly. Perhaps we must forego a heavy lather in our soap and be satisfied if it merely cuts the grime. In the case of tin, a frantic search is under way to develop lacquers or silver plating as substitutes. Although this will help, there is no doubt that the prepared food industry and many other civilian outlets for tin are due for thin times until the natural product is restored.

The most vital loss is rubber. Plans are now under way to build a reasonably large capacity for the synthetic product in both the United States and Canada. There will be very little in either development, however, to make private car owners happy. Already it is doubted that current plans will do more than fill the most essential needs—military, industrial and transport. Nor can production of ersatz rubber be increased easily. Bottle-necks exist in construction materials (especially fabricated steel) and the right types of labour. The equipment requires large amounts of stainless and heat-resisting steels at a time when all ferro-alloys are in desperately short supply. Moreover, once construction is complete it may take as much as another two years to determine the best techniques for processing synthetic rubber in all the forms for which it will be required.

TABLE OF EXCHANGE RATES

These are only samples of the difficulties created by successful aggression on the part of the Axis. Therefore it cannot be stressed too often that our potential economic superiority is no augury of victory. In any event, that superiority has been whittled away and is in danger of further deterioration in the very near future. From now on the only guarantee of success will be to exploit what we have at home to the very fullest extent; certainly we cannot always rely upon assured sources of materials from abroad. In other words, we must realize as we never did before that time does not necessarily work on our side.

Montreal,
17th March 1942.

TABLE OF EXCHANGE RATES

(Kindly supplied by The Canadian Bank of Commerce, Toronto)

	28th February 1942	15th March 1942
U.S. Dollars	10-11% P.	10-11% P.
Sterling	443-447	443-447
Australian Pounds	358½	358½
New Zealand Pounds	360	360
South African Pounds	443	443
British West Indian—Dollars .	9270	9270
India—Rupees	3358	3358
Hong Kong—Dollars (Custodian rate)	2781	2781
Straits Settlements— Dollars	(Last quotation 19th February) 5157	5157
Sweden—Kronor	2637	2637
Switzerland—Francs	2569	2569

Note: The above currencies are expressed as follows: Pound currencies—Canadian cents per unit; Continental currencies and sundry British Empire—Canadian cents per 100 units.

THE DOMINION ASSOCIATION OF CHARTERED ACCOUNTANTS

OFFICERS AND COUNCIL

Executive Committee 1941-42

President	Malcolm C. McCannel, C.A., Edmonton, Alberta
Vice-Presidents	{ Kris A. Mapp, F.C.A., Toronto, Ontario H. L. McMackin, C.A., Saint John, N.B.
Immediate Past President	W. G. Rowe, C.A., Vancouver, B.C.
Chairman, Finance Committee	Fred C. Hurst, F.C.A., Toronto, Ontario
Chairman, Legislation Committee..	Clayton F. Elderkin, C.A., Montreal, Quebec
Additional Member Executive Committee	Frederick Johnson, C.A., Winnipeg, Manitoba
Secretary-Treasurer	Austin H. Carr, M.A., C.A., 10 Adelaide St. East, Toronto

Council 1941-42

Representatives

Elected by

H. A. Black, C.A., Edmonton	{	The Institute of Chartered Accountants of Alberta
M. G. Graves, C.A., Calgary		
M. C. McCannel, C.A., Edmonton		
K. D. Creer, C.A., Vancouver	{	The Institute of Chartered Accountants of British Columbia
Wm. Macintosh, C.A., Vancouver		
J. Haydn Young, C.A., Vancouver		
R. T. Cunningham, C.A., Winnipeg	{	The Institute of Chartered Accountants of Manitoba
William Gray, C.A., Winnipeg		
Frederick Johnson, C.A., Winnipeg		
H. G. Norman, C.A., Montreal	{	The New Brunswick Institute of Chartered Accountants
Arthur E. Cox, F.C.A., Saint John		
T. H. Johnson, C.A., Halifax		
G. E. Martin, C.A., Halifax	{	The Institute of Chartered Accountants of Nova Scotia
J. F. Gibson, F.C.A., Toronto		
R. R. Grant, F.C.A., Toronto		
F. C. Hurst, F.C.A., Toronto	{	The Institute of Chartered Accountants of Ontario
T. H. Johnson, C.A., Halifax		
Wm. H. Campbell, C.A., Montreal		
C. F. Elderkin, C.A., Montreal	{	The Society of Chartered Ac- countants of the Province of Quebec
Alfred Smibert, C.A., Montreal		
C. P. DeRoche, C.A., Saskatoon		
M. Hesford, F.C.A., Swift Current	{	The Institute of Chartered Accountants of Saskatchewan
G. G. Patrick, C.A., Saskatoon		

Chairman of War Purposes Committee—Kris A. Mapp, F.C.A.
 Chairman, Magazine Committee—Harold P. Herington, F.C.A.
 Chairman, Committee on Education and Examinations—Gerald Jephcott, F.C.A.
 Chairman, Committee on Accounting Research—D. McK. McClelland, F.C.A.
 Chairman, Committee on Accounting Terminology—John Parton, F.C.A.

GENERAL NOTES

Matters of Interest to Members

The mid-year meeting of the executive committee of The Dominion Association of Chartered Accountants was held in Toronto on 5th and 6th March with the following members present: M. C. McCannel, Edmonton, president; Kris A. Mapp, Toronto, vice-president; Clayton F. Elderkin, Montreal; Fred C. Hurst, Toronto; Fred Johnson, Winnipeg; and Austin H. Carr, secretary-treasurer. Messrs. W. G. Rowe, Vancouver, immediate past president, and H. L. McMackin, Saint John, the other vice-president of the Association, were unavoidably absent.

During the year a number of distinguished members of the profession have passed away. Among these were Mr. A. F. C. Ross, who acted as secretary of the Dominion Association when it was incorporated in 1902 and who became its president in 1907-08; R. H. Hayward, one of the incorporators of the Institute of Chartered Accountants of Manitoba; W. E. Leverman, one of the incorporators of the Institute of Chartered Accountants of Nova Scotia; and John H. Williams, who had for years devoted his time and talents to the establishing well of the profession of the chartered accountant in the Province of Alberta. The executive committee went on record, expressing the appreciation of the Association at the contribution which these men had made to the profession.

The report of the President on his and the Secretary's visit to the last annual meeting of the American Institute of Accountants appeared in the November 1941 issue of THE CANADIAN CHARTERED ACCOUNTANT. Mr. McCannel referred again to the earnestness with which the members of the profession in the United States had entered into the proceedings of their annual meeting and mentioned particularly the active participation of the older members there in the presentation of technical papers and in the ensuing discussions.

The President reported also on the success of the trip to Ottawa of himself and the Secretary on 2nd March, and outlined the purposes of the organization of our members in the Civil Service. The group, he said, had not long been formed but from a record of its activities so far good re-

sults could be expected from such an organization in Ottawa.

Reciprocity Among Institutes—Up to the time of the annual meeting of the Dominion Association in Vancouver in August 1941, the five Institutes of Alberta, British Columbia, Ontario, Quebec and Saskatchewan had adopted the principle of reciprocity of entrance fees; i.e., each Institute will waive the entrance fee of any member in good standing of any of the other four Institutes on his application to membership. At that annual meeting it was recommended that to encourage the retention of membership in a member's "home" Institute the principle of reciprocity be extended to provide that "should a member of an Institute admitted under the reciprocal agreement cease to be a member of the Institute of which he was a member at the time of his application to the Institute of which he became a member by the reciprocal arrangements, he will then be required to pay the entrance fee to the Institute of which he became a member through such reciprocal arrangement." It was also provided that the Dominion Association collect one annual fee only in respect of each individual and that the same be collected from the Institute in which the individual has the membership of longest standing. To date the Institutes of Alberta, Manitoba, Quebec and Saskatchewan have adopted this recommendation of the annual meeting.

December 1941 Examinations—Gerald Jephcott, Chairman of the committee on education and examinations of the Provincial Institutes, reported that the December 1941 examinations had been held successfully but that the expenditures of conducting the same had exceeded the revenue from examination fees. A similar situation with respect to expenses, he pointed out, will arise in the June 1942 examination. The Institutes are already aware of this and will be bearing any deficit in proportion to the number of candidates writing.

War Purposes Committee—The scarcity of professional accountants and the demands made upon our profession for wartime services have been the subject of considerable discussion during the past few months. Many of our members have enlisted for military service and many others have gone into government departments, but there is still

a demand for more chartered accountants, particularly for the Income Tax Department, the Department of National Defence and the Department of Munitions and Supply, to say nothing of the requirements of industry for experienced men. It is apparent, then, that the services of chartered accountants should be conserved and made use of in a manner that will best serve the interests of the country. With this thought in mind the war purposes committee, of which Kris A. Mapp, F.C.A., is chairman, asked the various departments of the Dominion government to obtain a list of the chartered accountants employed in such departments. A report on this matter has been submitted to the councils of all the Provincial Institutes.

Legislation—Clayton F. Elderkin, chairman of the legislation committee, gave a report of the activities of his committee. In November a brief was submitted to the Commissioner of Income Tax requesting a clarification of Section 6 of *The Excess Profits Tax Act*, in respect of inventory reserves. In addition, it was requested that reserves be allowed in respect of normal wartime inventories for the purpose of computing excess profits taxes under both the first and second part of the second schedule of the Act. The latter request was refused, but a ruling was received from the Commissioner and was distributed by our Association to all members. At the same time the Commissioner explained his reasons for refusing the additional reserve in a letter which was later published in *THE CANADIAN CHARTERED ACCOUNTANT*. Attention was also given to the apparent inequity of establishing the standard profits under *The Excess Profits Tax Act* at a minimum of \$5,000 before partners' salaries in the case of a partnership whereas in the case of a corporation the minimum standard profit was established at \$5,000 after salaries. The Department adhered to this interpretation of the Act, but recently the Minister of Finance announced in the House of Commons that hereafter the Act would be interpreted to permit a minimum standard profit of \$5,000 after salaries in the case of both incorporated companies and partnerships.

Following the passing of the Wartime Wages and Cost of Living Bonus Order and the Wartime Salaries Order our legislation committee held more than one interview with the Labour Board officials on the application of the governmental orders, and the information received was despatched

by the secretary-treasurer's office to the Provincial Institutes.

Certain suggested amendments of the *Income War Tax Act* and *The Excess Profits Tax Act*, have been received from our members and are having the attention of the committee.

Tax Information—The secretary-treasurer reported that the members had been kept informed on such government orders in council respecting wages, salaries and prices as appeared of special interest to them. These were included in communications to members on 10th October, 3rd and 22nd November, 3rd and 17th December and 19th February. In addition, typewritten and printed copies of government releases on matters met with by chartered accountants in their practice, and of the full text of judgments of the exchequer court and the supreme court of Canada in income tax cases, had been sent by the secretary-treasurer's office to the provincial Institutes for their reference libraries. The executive committee decided that the Association should continue to keep the members posted as much as possible on Dominion income and excess profits taxes and on wartime wages and salaries.

Finances—Fred C. Hurst, chairman of the finance committee, reported on the finances of the Association for the year ending 31st May 1942. Because of the increasing activities of the Dominion secretariat it was found necessary to enlarge the office early in the new year, which meant some additional expense. The cost of printing more frequent instalments of information for members and the necessity of reprinting the volume of legal decisions and income tax rulings have made heavy demands on the exchequer of the Association, but the chairman anticipated that expenditures would be kept within the revenues for the year.

Annual Meeting 1942—In view of wartime conditions, the executive committee has decided to restrict the annual meeting of 1942 to the meeting of council and a half-day general session for members. The tentative dates chosen are 17th to 19th August. It was decided that an address on Post-War Problems, by some person familiar with world conditions, will be the feature if possible of the general session of members, and that the meeting on this occasion be thrown open to the public, thus making possible a more general discussion of the subject.

The Canadian Chartered Accountant—The secretary-treasurer reported on the continued progress and success of THE CANADIAN CHARTERED ACCOUNTANT. The monthly run continues to increase and for March it was 4,600 copies. Harold P. Herington, chairman of the editorial committee, discussed with the executive committee the importance of the older members of the profession contributing articles to the magazine. There are numerous problems in industry that should be discussed by our members for the benefit of other members, and the monthly magazine, he said, is the best possible medium for this purpose. In order to keep members and students in military service informed on the profession, fifty copies of each month's issue are being supplied to Canadian Legion War Services, Inc. for reading rooms here and abroad.

Entertainment—At noon on Thursday the members of the executive committee were guests of Mr. Mapp at the National Club, and at noon on Friday of the President and Council of the Institute of Chartered Accountants of Ontario. They were again the guests of the Ontario Institute at its mid-year dinner Friday evening at which a very informative address on Canada's war activities was given by Hon. C. D. Howe, Minister of Munitions and Supply. The committee expressed its deep appreciation of these courtesies during its stay in Toronto.

Ottawa Chartered Accountants' Dinner

History was made when Mr. Malcolm C. McCannel and Mr. Austin H. Carr were the guest speakers at a dinner held in their honour in Ottawa on 2nd March. It was the first time that officers of The Dominion Association of Chartered Accountants in their official capacities had visited the members in Ottawa and it was also the first opportunity all the chartered accountants in Ottawa have had of assembling in their own city. The dinner meeting was held under the auspices of the recently formed Chartered Accountants' Group of the Professional Institute of the Civil Service of Canada.

After welcoming the guests, Chairman W. F. Chown explained that the Group had been formed to meet a need for fellowship and co-operation among the chartered ac-

countants in the service of the Dominion government. He pointed out that the number of chartered accountants employed in the public service in Ottawa had been gradually increasing before the war and that since the extension of government control over our wartime economy the number had grown very rapidly. This was a high tribute to the profession. There are in the government service representatives of all Provincial Institutes and these are bound together by a common membership in the Dominion Association.

Mr. McCannel, in his first official speech since his election to the office of President, won the high regard of the audience by his witty and friendly manner combined with the shrewdness of his observations in a more serious vein. He outlined the early organization of the Provincial Institutes and of the Dominion Association, pointing out the importance which has been placed on the professional education of the new generation of accountants. He appealed for full co-operation in the war effort and deplored the obstructive actions of some opposition members that he had witnessed during his afternoon visit to the House of Commons. His address appears elsewhere in this month's issue.

Mr. Carr outlined the tremendous development which has taken place in the services rendered by and expected of chartered accountants. More and more recognition is being given to the value of their training and experience; no longer are they regarded as mere checkers of accounts. He anticipated further developments in the years to come. As editor of *The Canadian Chartered Accountant* he appealed for articles for the Association's magazine. He stressed the benefits to the writer who must go deeply into the subject and who puts much painstaking effort into the preparation of his material.

Mr. A. M. Henderson expressed sincere thanks to the guests of honour on behalf of more than a hundred present. During the evening Mr. Richard Pentland sang several solos, accompanied by Mr. Norman Pragnell, and also led a sing-song. Mr. L. S. Drummond headed the committee responsible for the dinner arrangements.

Index Figures of Living Costs

The Dominion Bureau of Statistics has announced that the cost-of-living index increased from 115.4 on 2nd January 1942 to 115.7 on 2nd February 1942. This index has risen 14.8 per cent between August 1939 and February 1942. (Previous reference—page 189 of March issue).

Concentration of Industry

The Economist (London) of 8th March 1942 in a leading article sets out that the mechanism of concentration in industry utilized in peacetime to control and restrict production might be equally well applied in the present circumstances for the same purposes.

The article suggests that to obtain a more complete war effort that portion of industry concerned with the production of consumer goods should be concentrated in order that a full-time production schedule may be put into operation by certain units of the industry in place of the part-time production schedules now in force throughout the whole of the consumer goods industry arising from the limitation of supplies. The resources so eliminated by this concentration could then be diverted towards the production of war materials.

PROVINCIAL NEWS

SASKATCHEWAN

REGINA

The Regina Chartered Accountants' Club held the regular monthly meeting on Thursday evening at the Kitchener Hotel. The guest speaker of the evening was Mr. F. B. Bagshaw, K.C., who discussed a number of interesting features of the Wartime Prices and Trade Regulations. Mr. Bagshaw made particular reference to various ways in which the practising chartered accountant can assist in the administration of the regulations.

Mr. G. M. Campbell and Mr. P. G. Larter, who were successful candidates in the recent chartered accountant examinations, received their diplomas from Mr. W. E. Hodge, F.C.A., Moose Jaw, who is a past president of The Dominion Association of Chartered Accountants.

A guest of the evening was Pilot Officer E. Harris, C.A., of London, England. Pilot Officer Harris was in Oslo, Norway, working for Price, Waterhouse and Company at the time of the German invasion. He gave a very interesting account of his escape via Sweden, Russia and Japan, where he boarded the Empress of Asia for Canada. Pilot Officer Harris joined the R.C.A.F. shortly after his arrival in Canada in the fall of 1940 and is now an instructor at the Regina airport.

ONTARIO

The annual mid-winter dinner and reception to new members of the Ontario Institute was held in the Royal York Hotel, Toronto, on Friday, 6th March 1942, at which nearly 450 members, students and guests were present and heard The Honourable C. D. Howe, Minister of Munitions and Supply, speak on Canadian war production. Mr. A. Stan. Tindale, C.A., Comptroller, Department of Munitions and Supply, introduced the speaker and Mr. Gerald Jephcott, F.C.A., immediate Past-President of the Institute, moved the vote of thanks.

The toast to "Our Guests" was proposed by Mr. Russel R. Grant, Second Vice-President and responded to by Mr. C. R. Sanderson, President, Empire Club of Canada. The Institute was honoured in having among its guests: General C. F. Constantine, A. C. Military District No. 2; Controller Saunders, representing the City of Toronto; Dr. F. A. Gaby, President, The Board of Trade; Mr. D. L. McCarthy, K.C., Treasurer, The Law Society of Upper Canada; Mr. John Miller, President, The Canadian National Exhibition; Mr. K. A. Richardson, President, Toronto Stock Exchange; Mr. A. E. Arscott, Vice-President, Canadian Bankers' Association; Mr. F. H. Brown, Canadian Manufacturers' Association; Mr. C. Fraser Elliott, K.C., Commissioner of Income Tax; Mr. Hugh D. Paterson, Inspector of Income Tax; Mr. Floyd Chalmers, Editor, The Financial Post; Mr. J. A. McNeill, General Manager, The Canadian Press. The Dominion Association of Chartered Accountants was represented by Mr. M. C. McCannel, President, and Mr. Kris A. Mapp, Vice-President; Mr. C. F. Elderkin, C.A., represented the Quebec Society and Mr. F. Johnson, C.A., the Manitoba

Institute. Queen's University was represented by Professor R. G. H. Smails, Acting Director of Accounting Courses.

The various prizes awarded by the Institute in the recent examinations were presented by Mr. F. C. Hurst, F.C.A., First Vice-President, and the gold medal awarded to E. D. Berry, Jr., Ottawa, by the Board of Examiners-in-Chief of the Provincial Institutes for the highest standing in Canada in the accounting and auditing papers of the Final examination by Mr. M. C. McCannel, President, the Dominion Association.

The meeting was presided over by Mr. J. F. Gibson, F.C.A., President, who before presenting the certificates of membership addressed the new members as follows:

"There now devolves upon me the pleasant task of welcoming into membership those who were successful in the recent Institute examinations, and of presenting to them the tangible evidence of their success.

"Before asking you, our new members, to come forward, I have a few words to say: first, of sincere greeting and, second, with respect to the duties and responsibilities you now assume as Chartered Accountants.

"I welcome you most heartily into the ranks of the Ontario Institute. New blood is as welcome as it is vitally necessary to our continued progress and usefulness. After years of arduous practical training and study, you have attained your objective, and I know your fellow-members all join with me in extending very sincere congratulations.

"Doubtless you all feel pride in the fact that you are now entitled to the designation 'Chartered Accountant,' and that is as it should be. The standing of the profession of the Chartered Accountant in Canada, and indeed throughout the British Empire, is such as to be a source of pride to all of us. That happy condition was not brought about by chance. It is due to the fact that those who have preceded you in this profession have established the highest professional standards on a solid foundation of integrity and service.

"You now assume the duty and responsibility, common to us all, of maintaining and strengthening those standards. I am sure you will accept and faithfully discharge your obligation to this Institute in particular, and the profession in general. In so doing you will protect and enhance the value of your greatest asset—your reputation."

ALBERTA

EDMONTON

The members of the Edmonton Chartered Accountants' Club attended a dinner meeting at the Edmonton Club on Friday evening 13th March 1942 in honour of Charles M. Lang, F.C.A., who is shortly retiring from service as provincial auditor with the Provincial government.

J. G. Duncan, president of the Club, presented Mr. Lang with a suitable remembrance from its members and paid tribute to his thirty-two years of membership in the Institute of Chartered Accountants of Alberta. His valued advice and counsels will be missed both by the Institute and the Edmonton Chartered Accountants' Club.

The students from Edmonton, who successfully passed the Final examination in December 1941, were introduced to the members along with Mr. K. MacFadyen of Calgary, also a successful student.

LAC B. Cooper, A.C.A. of Melbourne, Australia, was also a guest at the meeting. LAC Cooper became a chartered accountant in Australia last May and spoke to the members on the Chartered Accountants' organization in Australia.

PERSONALS

Messrs. H. L. Burch & Company, chartered accountants, announce that they have moved to 816 Toronto General Trusts Building, Portage at Smith Street, Winnipeg, Manitoba.

Maurice H. and David S. Katz, members of the Society of Chartered Accountants of the Province of Quebec, announce that they are now carrying on the practice of their profession under the firm name of M. H. and D. S. Katz & Company, chartered accountants, with offices at Suite 224, Drummond Building, 1117 St. Catherine Street West, Montreal, P.Q.

William V. Victor and Company, chartered accountants, Montreal, announce that Mr. Saul Reisler, chartered accountant, has been admitted to partnership. The latter has been associated with the firm for some years.

BOOK REVIEW

A DIGEST OF EXCESS PROFITS TAX CASES of the British Commonwealth of Nations and principal divisions thereof.

By Molyneux L. Gordon, K.C.

(Published by the Author, 330 Bay Street, Toronto, 1942; cloth, 300 pp.)

Mr. Gordon, whose Digest of Income Tax Cases is well known to chartered accountants, has now published a companion digest of Excess Profits Tax cases. The author continues the concise form of summarizing the judgments and of noting references to the complete reports of the cases. An appendix quotes the sections of the various statutes to which references are made in the cases.

With one exception the cases all relate to taxation legislation enacted during or immediately after the last war, and the reader, therefore, must take into account any differences between the present and prior statutes in studying the current application of the judgments.

Perhaps the cases of most interest to chartered accountants in dealing with Canadian Excess Profits Taxes at the present time, are those covering the determination of capital employed. Those dealing with losses on forward contracts will also prove instructive in illustrating the views of the English courts on the treatment of anticipated losses on future deliveries, both from a taxation and from a purely accounting viewpoint.

The volume will prove a valuable and interesting companion to the more voluminous Digest of Income Tax Cases.

Montreal,
16th March 1942.

ALBERT E. BISHOP,
Chartered Accountant.

OBITUARY

The Late Kenneth Hugh Chamberlain

The Institute of Chartered Accountants of Ontario regrets to announce the death of Kenneth Hugh Chamberlain at Riverton, New Jersey, U.S.A., on 10th January 1942, in his 47th year.

The late Mr. Chamberlain was a veteran of the first Great War, having served with the C.E.F. as a commissioned officer. His practical experience to qualify for membership was received in the Ottawa office of Messrs. Oscar Hudson & Company and, following graduation in 1928, he took up residence in the United States. He was associated with the New York office of Lybrand, Ross Bros. & Montgomery until 1940, when he became general auditor for the United States Pipe and Foundry Company.

To his widow, children and other members of his family, the Institute extends sincere sympathy.

OBITUARIES

The Late George Stanley Laing

It is with regret that the Institute of Chartered Accountants of Manitoba records the death at Winnipeg on 2nd March 1942 in his 65th year of George Stanley Laing.

Mr. Laing was born in London, Ontario. In 1914 he enlisted and went overseas as a Major with the 27th Battalion, later serving with the 78th Battalion. He was wounded at Passchendale in 1917.

Mr. Laing joined the Institute of Chartered Accountants in 1910 and after his return from overseas he organized the firm of G. S. Laing & Company with which he was actively engaged until his death.

His wife predeceased him many years ago. One of his sons, Lt. Stanley B. Laing, C.A., is at present overseas with the Canadian Forces.

To his two sons and daughter the profession extends sincere sympathy.

The Late Harold James Morden

The Institute of Chartered Accountants of Manitoba announces with regret the death at the age of 72 of Harold James Morden on 28th February.

Born at Picton, Ontario, in 1869, Mr. Morden was first employed by the Bank of Montreal in Mexico City. He came to Winnipeg in 1914 and joined the staff of Oscar, Hudson and Company and subsequently became the resident partner in Winnipeg. In 1940, he acquired the practice of Oscar, Hudson and Company in Winnipeg, and carried on the practice in his own name until his death.

Mr. Morden was very active in public affairs. He was President of the Board of Directors of the Motor Country Club, and an active member of the Board of Trade. He was also a member of the Canadian Club, the Winter Club, and both the Elmhurst and Southwood Golf Clubs. He was associated with Augustine United Church for many years.

Mr. Morden leaves behind him his wife, to whom the sympathy of the Institute is extended.

STUDENTS' DEPARTMENT

R. G. H. SMAILS, C.A., Editor

NOTES AND COMMENT

It has always seemed very doubtful whether a book could be written on the subject of business investigations which would be of much use either to the practising accountant or to the student of accounting preparing to write his examinations. We recently encountered however a little volume by Finnie and Berlanny¹ which removes this doubt.

The authors' success lies in their refusal to get bogged down in discussion of "investigations that are simply specialized exercises in auditing, such as enquiries in connection with tax matters, certification of quotas, arbitrations and the like" and their concentration, to the exclusion of all else, upon the problem of the valuation of a business. The accurate valuation of a business depends upon an accurate estimate of its earning capacity and the formulation of an accurate estimate of earning capacity involves an enquiry into all the factors both internal or external which have a bearing upon the present condition and future prospects of a business. The enquiry is thus of a type which is equally useful whether its purpose is the establishment of a fair price for a sale of a business or the diagnosis and correction of ailments in a business which is not for sale.

The authors having restricted themselves to two hundred pages have been able to produce a piece of prose writing which is much more polished than that of most texts written by or for accountants and which stimulates rather than deadens the imagination of the reader. Out of those two hundred pages they have contrived to devote fifteen to the presentation of an illustrative report issuing from an investigation into the affairs of a manufacturing company which was proposing to issue additional capital for the purpose of establishing a new department.

Some North American readers may be a little put out by the fact that the institutional background of the book, its accounting forms and its terminology are English rather than American but the slight translation effort involved should not prove a serious obstacle to anyone.

¹David Finnie and S. S. Berlanny, *Business Investigations*, (Pitman, 1938), pp. 205, \$3.75.

A simple device for computing interest on a series of equal periodic sums (such as partners' regular monthly drawings, or contributions to a savings fund) is that known as the "average date" or "average period" method. It rests on the fact that the sum of interest earnings on a series of equal payments at equal time intervals, is equivalent to interest on the sum of the payments for the average period of all the payments. The various periods constitute an arithmetic progression and therefore the average period is $\frac{a + l}{2}$ where "a" is the first period and "l" the last period.

By way of illustration let us suppose that we wish to check the annual interest earnings (at 4 per cent per annum) on a contribution of \$25 made to a pension fund on the first day of each month in the calendar year. The first payment earns interest for twelve months, the last payment for one month, and so the average period of all payments is $\frac{12 + 1}{2} = 6\frac{1}{2}$ months. The sum of the twelve payments is $12 \times \$25 = \300 and the interest earned is therefore $\$300 \times \frac{4}{100} \times \frac{13}{24} = \6.50 .

A further illustration would be the calculation of interest on partners' drawings at 5 per cent per annum where drawings for the business year had been: A, \$500 on the middle day of each month; B, \$1,250 on 31st March, 30th June, 30th September and 31st December; C, \$312.50 on the last day of each month.

The calculations of the average period for A, B, and C. respectively are:

$$\frac{11\frac{1}{2} + \frac{1}{2}}{2} = 6 \text{ months}$$

$$\frac{9 + 0}{2} = 4\frac{1}{2} \text{ months}$$

$$\frac{11 + 0}{2} = 5\frac{1}{2} \text{ months}$$

The interest chargeable is therefore:

$$\text{A, } \$6,000 \times \frac{5}{100} \times \frac{6}{12} = \$150.00$$

$$\text{B, } \$5,000 \times \frac{5}{100} \times \frac{9}{24} = \$93.75$$

$$\text{C, } \$3,750 \times \frac{5}{100} \times \frac{11}{24} = \$85.94$$

STUDENTS' ASSOCIATION NOTES

ALBERTA

Edmonton—The Chartered Accountant Students' Association of Edmonton held its annual meeting on Tuesday evening, 10th March, at the Royal George Hotel. The meeting was particularly well attended, the only acceptable excuses being Army parades, and the students were amply rewarded by the splendid talk prepared by Mr. Alex. Hamilton, B.Sc., B.Com., winner of the gold medal offered by the Provincial Institute at the recent examinations.

Mr. Hamilton spoke on the organization of study material, stressing the important part organization plays in the study program. He also gave first-hand information on study groups; and before the students departed for their homes, seven tentative study groups had been organized, two in the primary, two in the intermediate, and three in the senior divisions. It is being planned to obtain the services of chartered accountants to act as consultants for each group.

After fortifying themselves with a turkey dinner the boys undertook to elect a new executive. Appreciation of the work done by the retiring executive, Ed. King, Bruce Sangster and George Mowatt, was expressed by the gathering. Results of the balloting returned Bruce Sangster, President; Joe Fisher, Vice-President; and Dave Tait, Secretary-Treasurer for the coming year.

The meeting then adjourned except for several incurables who were deeply involved in table cloth diagrams.

QUEBEC

According to a report received by his parents, Mr. and Mrs. H. A. Green of 753 Rockland Avenue, Outremont, Pilot Officer Roy A. Green, R.C.A.F., who was reported missing after air operations 16th-17th February, is now interned in Tunisia and is injured.

Pilot Officer Green was in the employ of Messrs. P. S. Ross & Sons and was in the final year of the chartered accountants' course when he enlisted eighteen months ago. A popular member of the Students' Society, he went overseas last September. A brother, Pilot Officer Geoffrey Wm. Green, a chartered accountant, is also overseas.

All members and students are glad that Roy was successful in making a safe landing.

PROBLEMS AND SOLUTIONS

EXAMINATIONS OF THE PROVINCIAL INSTITUTES OF CHARTERED ACCOUNTANTS

Solutions presented in this section are prepared by practising members of the several provincial Institutes and represent the personal views and opinions of those members. They are designed not as models for submission to the examiner but rather as such discussion and explanation of the problem as will make its study of benefit to the student. Discussion of solutions presented is cordially invited.

PROBLEM I

FINAL EXAMINATION, JUNE 1941

Accounting III, Question 1 (15 marks)

On 31st December 1935 Company A purchased for \$20,000 a 50% interest in the common stock of Company B which latter at that time had a paid-up capital of 200 shares having par value \$100 each and a surplus equal to 50% of the paid-up capital. On 31st December 1940 Company A purchased a further 25% of the outstanding common stock of Company B for \$20,000. On 31st December 1940 the surplus account of B stood at \$50,000. On 15th January 1941 Company B paid a dividend of 100%. Company A was organized solely for the purpose of acquiring the stock of B. It has no other assets and issued its \$100 par value shares at par in the acquisition of the shares in Company B.

(a) What would be the amount of goodwill or surplus on consolidation, as the case may be, in a consolidated balance sheet as at 31st December 1940? Show how you arrive at the result.

(b) Prepare a consolidated balance sheet as of 31st January 1941. Company B's operations during January 1941 show neither a profit nor a loss (all accounts other than goodwill, capital stock, surpluses and profit and loss accounts to be shown as net assets). Show working consolidated balance sheet.

SOLUTION

(a) Shares Acquired by Company A in Company B

Date	Number of Shares	Cost of Shares	Book Worth of Shares
31st Dec. 1935	100	\$20,000	(20,000 + 10,000) = \$15,000
31st Dec. 1940	50	20,000	50 (20,000 + 50,000) = 17,500
	150	\$40,000	\$32,500

Goodwill on consolidation is therefore \$40,000 — \$32,500 = \$7,500.

(b) Journal entries to Produce the Balance Sheet of Company A at 31st January, 1941.

1935		
Dec. 31	Investment in Company B	\$20,000
	To Capital	\$20,000
	Purchase of a 50 per cent interest.	

STUDENTS' DEPARTMENT

1940

Dec. 31	Investment in Company B	20,000	
	To Surplus		20,000
	To take up 50 per cent of Company B's earnings since 31st December 1935.		
31	Investment in Company B	20,000	
	To Capital		20,000
	Purchase of a 25 per cent interest.		

1941

Jan. 15	Bank (Net Assets)	15,000	
	To Investment in Company B		15,000
	Receipt of dividend of 100 per cent on 150 shares of \$100 each.		

The balance sheets of the two companies at 31st January 1941 are therefore:

Company A

Net assets	\$15,000	Capital	\$40,000
Investment in B	45,000	Surplus	20,000
	<u>\$60,000</u>		<u>\$60,000</u>

Company B

Net assets	\$50,000	Capital	\$20,000
		Surplus	30,000
	<u>\$50,000</u>		<u>\$50,000</u>

WORKING CONSOLIDATED BALANCE SHEET OF COMPANY A AND SUBSIDIARY COMPANY B as at 31st January 1941

Item	A	B	Eliminations	Final
<i>Debits</i>				
Net assets	\$15,000	\$50,000	—	\$65,000
Investment in Company B ...	45,000	—	\$45,000	—
Goodwill on consolidation	—	—	—	7,500
	<u>\$60,000</u>	<u>\$50,000</u>	<u>\$45,000</u>	<u>\$72,500</u>
<i>Credits</i>				
Capital—Company A	\$40,000	—	—	\$40,000
Surplus—Company A	20,000	—	—	20,000
Capital—Company B	—	\$20,000	\$15,000	5,000
Surplus—Company B	—	30,000	22,500	7,500
	<u>\$60,000</u>	<u>\$50,000</u>	<u>\$37,500</u>	<u>\$72,500</u>

CONSOLIDATED BALANCE SHEET OF COMPANY A AND SUBSIDIARY COMPANY B as at 31st January 1941

Net assets	\$65,000	Minority interests	\$12,500
Goodwill on consolidation	7,500	Capital	\$40,000
		Surplus	20,000
			<u>60,000</u>
	<u>\$72,500</u>		<u>\$72,500</u>

PROBLEM II

FINAL EXAMINATION, JUNE 1941

Accounting III, Question 3 (25 marks)

A died on 15th April 1938. The assets of his estate consisted of the following: cash \$250, which the widow appropriated (this was charged to her on account of income); cash in bank \$11,000; 2,000 shares of Green Company Limited 6% preference stock each of \$100 par value, dividend payable 15th days of January and July, market value \$100 per share; 4,800 shares of Blue Company Limited common stock each of \$25 par value, dividends payable 15th days of February, May, August and November at 4% per annum, market value \$20 per share; \$100,000 Dominion of Canada bonds, interest 4% per annum payable 15th days of January and July, market value 98; residence \$60,000; chattels \$20,000; warehouse block \$100,000.

Under the will the widow received the residence and chattels and the entire net income from the estate during her lifetime. On her death one-third of the estate or \$165,000, whichever was greater, was to go to an invalid daughter and the remainder to four other children equally. The widow died on 15th October 1940. In the meantime the following realization of assets had taken place:

15th July 1940, sold 500 shares of Green Company preference ex-dividend at 110;

15th Sept. 1940, sold 1,200 shares of Blue Company common at 22.50.

On 15th October 1940 the assets were valued and sold to realize the following:

Green Company Limited preference stock, \$112 per share;

Blue Company Limited common, \$22 per share;

Dominion of Canada bonds, \$102 per 100;

Warehouse block, \$50,000.

Ignoring any questions of testamentary expenses, executors' fees or succession duties, you are required to give the capital or corpus account of the estate as it would appear in the ledger, showing the amount of each child's share in the estate at 15th October 1940. Time is to be computed in months or half-months.

SOLUTION

BOOKS OF THE ESTATE OF "A," DECEASED

CAPITAL ACCOUNT		Debit	Credit
1938			
April 15	Widow's income account (Cash in house).		\$ 250
15	Cash in bank		11,000
15	2,000 6% preference shares of Green Company Limited, par value \$100, dividend 15th January and 15th July, @ \$100 each		200,000
15	4,800 common shares of Blue Company Limited, par value \$25, dividend 15th February, 15th May, 15th August and 15th November, @ \$20 each		96,000
15	\$100,000 Dominion of Canada 4% bonds, interest payable 15th January and 15th July, @ 98 per cent		98,000

STUDENTS' DEPARTMENT

15	Residence	60,000
15	Chattels	20,000
15	Warehouse block	100,000
15	Accrued interest—Dominion of Canada 4% bonds, three months	1,000
15	Widow's legacy account—for transfer of residence	\$ 60,000
15	Widow's legacy account—for transfer of chattels	20,000
1940		
July 15	Profit on sale of 500 preference shares of Green Company Limited, book worth \$98.50, sold @ \$110 each	5,750
Sept. 15	Profit on sale of 1,200 common shares of Blue Company Limited, book worth \$19.333, sold @ \$22.50 each	3,200
Oct. 15	Profit on sale of 1,500 preference shares of Green Company Limited, book worth \$98.50, sold @ \$112 each	20,250
15	Profit on sale of 3,600 common shares of Blue Company Limited, book worth \$19.333, sold @ \$22.00 each	7,800
15	Profit on sale of \$100,000 Dominion of Canada 4% bonds, cost \$98, sold @ \$102 per cent	4,000
15	Loss on sale of warehouse block, cost \$100,000, sold for \$50,000	50,000
15	Distribution— Invalid daughter	165,750
	Four remaining children \$82,875 each)	331,500
		<u>\$627,250</u>
		<u>\$627,250</u>

NOTES:

(1) In practice the estate Capital Account sometimes shows only cash transactions. A candidate would receive credit if his Capital Account showed only the proceeds from original assets when sold.

(2) The book worth of the 6% preference shares of Green Company Limited is computed thus:

Probate value of 2,000 shares of \$100 each	\$200,000
Deduct: Portion of dividend received 15th July 1938 which had accrued at date of death, 3 months @ 6% per annum	3,000
	<u>\$197,000</u>
Per share	<u>\$ 98.50</u>

(3) The book worth of the common shares of Blue Company Limited is computed thus:

Probate value of 4,800 shares of \$25 each	\$ 96,000
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THE CANADIAN CHARTERED ACCOUNTANT

<i>Deduct:</i> Portion of dividend received 15th May 1938 which had accrued at date of death, 2 months @ 4% per annum	800
	<u>\$ 95,200</u>
Per share	<u>\$ 19.8333</u>

PROBLEM III

FINAL EXAMINATION, JUNE 1941

Accounting I, Question 2 (20 marks)

Company A and Company B carrying on similar types of business agree to amalgamate and you are asked to prepare a plan of amalgamation and to prepare such statements and explanations as you consider advisable. Excepting for qualifying shares, each company is owned and operated by two men and it is agreed that all four will continue in the new company, total present salaries to the owners to be continued but divided equally between them. It is stipulated that neither of the two groups shall exercise control in the new company. If interest or dividend rates are used in your submission, 5% is agreed upon. All income taxes in respect of both companies have been properly provided for.

You are furnished with the following information by the two companies:

	<i>Company A</i>	<i>Company B</i>
Net current assets	\$ 15,000	\$ 6,000
Fixed assets	120,000	60,000
Goodwill	15,000
Investments (to be retained by present owners)	10,000
Capital	100,000	60,000
Surplus	50,000	16,000
Average profits for five years 1935-1939 both inclusive, as determined by the companies after taxation	13,900	7,700

Appraisals as at 31st December 1939 establish values which produce the following adjustments:

Buildings

Company A—add	\$8,000
Company B—deduct	4,000

Machinery

Company A—deduct	3,000
Company B—add	2,000

Uniform rates of depreciation of 2½% on buildings and 10% on machinery used by both companies are to be continued.

Upon enquiry you find that yearly salaries of \$4,000 each had been paid to the owners of Company A and \$6,000 each to the owners of Company B. You also discover that in year 1939, Company B had charged to repairs a new machine which cost \$3,000 installed. Further, income from investments of Company B had been \$500 in each of the years 1938 and 1939.

STUDENTS' DEPARTMENT

SOLUTION

There are two principles which should be preserved in a plan of amalgamation, namely, to issue major securities for net tangible assets acquired and to provide for earning power by the issue of junior securities. In addition, it is important that statements of the companies concerned in the plan of amalgamation should be prepared on a uniform basis. In the problem submitted, there is an additional stipulation that neither group should be able to exercise control of the new company.

The question states that the average annual profit for five years was \$13,900 for Company A and \$7,700 for Company B. Since there are certain adjustments to these amounts, it will be necessary to arrive at new averages and the following shows the results in this connection:

	<i>Company A</i>	<i>Company B</i>
Average profits as stated	\$ 13,900	\$ 7,700
Multiply by 5 to arrive at total	\$ 69,500	\$ 38,500
Add: Salaries paid during 5 years	40,000	60,000
Machine charged as repairs	—	3,000
	109,500	101,500
Deduct: Income from investments in years 1938 and 1939	—	1,000
	109,500	100,500
Divide by 5 to arrive at new average	21,900	20,100
Deduct: Equalized salaries	10,000	10,000
	11,900	10,100
Adjustments of depreciation by appraisals		
Buildings at 2½%deduct	200	add 100
	11,700	10,200
Machinery at 10%add	300	deduct 200
	12,000	10,000
Adjusted net profits	\$ 12,000	\$ 10,000
Net worth as stated	\$150,000	\$ 76,000
Deduct: Goodwill	15,000	
Investments	—	10,000
	135,000	66,000
Appraisal adjustments		
Buildingsadd	8,000	deduct 4,000
Machinerydeduct	3,000	add 2,000
Adjusted net tangible assets	\$140,000	\$ 64,000

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Major securities to be issued bearing a return of 5% for these amounts:

	<i>Company A</i>	<i>Company B</i>
Adjusted net profits as above	\$ 12,000	\$ 10,000
5% on major securities	7,000	3,200
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Balance of earnings to be reflected by the issue of shares without nominal or par value	\$ 5,000	\$ 6,800
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In order to meet the stipulation that neither group should exercise control in the new company, two classes of shares without nominal or par value could be created. The two classes would be equal in all respects, but each class would elect 50% of the directors. The by-laws of the company could provide that the chairman would only have one vote.

